



The Law Society



Capital allowances

Seizing the opportunity





About the research

The capital allowances research was conducted with members of the Law Society who are involved in commercial property transactions. Its aim was to understand the impact of the recent changes to capital allowances rules on the attitudes and day-to-day work of solicitors dealing with commercial property transactions. Another key objective was to investigate how the Law Society, together with its endorsed partner Catax Solutions, can support solicitors dealing with commercial property transactions. This report analyses the findings from a survey carried out in January 2015. The research attracted 219 responses. The Law Society is very grateful to all members who have given up their time to respond.

Introduction

The Finance Act 2012 has fundamentally changed the landscape of capital allowances, and placed a much higher emphasis on the role of conveyancing solicitors in ensuring this tax relief is not lost at the point of acquisition or disposal.

From April 2014 onwards, solicitors acting on property transactions are obliged to raise the issue of capital allowances relief with their clients. This is because the changes to capital allowances rules mean that purchasers and sellers have to protect their right to claim allowances early, otherwise they risk losing the ability to claim.

Capital allowances are available to any UK taxpaying entity incurring capital expenditure which could include the purchasing of a commercial property. Commercial property owners are entitled to a tax relief in the form of capital allowances on qualifying items of plant and machinery installations within a commercial property.

According to Catax Solutions, the UK's largest capital allowances specialist, the vast majority of commercial property owners are not claiming all of the capital allowances they are entitled to. However, solicitors can help clients address this issue.

“To a large extent this recent research confirms what the profession has always known, namely that our understanding of capital allowances has been sadly lacking. We should take steps to ensure that we are advising our clients fully and properly in these areas and that clients and ourselves as practitioners benefit from ensuring best practice. The Property Section is committed to ensuring that the education which the research shows to be necessary is promoted and that this important area of our work is highlighted.”

Ian White
Chair, Law Society Property Section



Executive summary

Between them, the Law Society and capital allowances specialists issued a great deal of guidance to solicitors and their clients about the changes to the capital allowances legislation in April 2014. However, our research shows that there is still a significant knowledge gap about capital allowances, amongst both solicitors and purchasers and sellers of commercial property.

Not all solicitors realise their duty of care towards clients and many see capital allowances as an issue for accountants. Furthermore, most don't realise that capital allowances work is likely to be lucrative for both the solicitor and the client, and that it doesn't have to delay the property transaction.

On the surface, it may seem that the new legislation has had a negative impact – increased administrative burden, reduced efficiency of the conveyancing process and the risk of having difficult client discussions, to name but a few.

Our research, however, shows that those solicitors who embrace it can expect to position themselves as trusted advisors, record increased customer satisfaction and develop valuable relationships with professional services suppliers.

The research also highlights that those who have experienced an increasing volume of work in the past year tend to be least interested in issues related to capital allowances. This suggests that a steady increase in volumes of work over recent years may have given rise to complacency and prevented otherwise high-performing practices from exploring the requirements and opportunities related to capital allowances. It also explains why those practitioners whose firms have seen a slower increase in the volume of work are particularly curious about capital allowances. Interestingly, regardless of the levels of growth already experienced, more complacent solicitors were more likely to expect a slowing growth rate in the future. Notwithstanding the commercial merits, solicitors have a duty to provide advice to clients on capital allowances.



Negative perceptions in a booming marketplace

Solicitors experience a myriad of challenges in their day-to-day commercial property work. 62% feel that clients impose unreasonable timelines, half report that the property information they need in order to process a transaction is either incomplete or unavailable. Many are concerned about buyers not being able to finance the purchase or sellers not having a complete planning history – a particular problem for small firms (43%). Last-minute demands from buyers and sellers as well as problems with local search delays are also frequent.

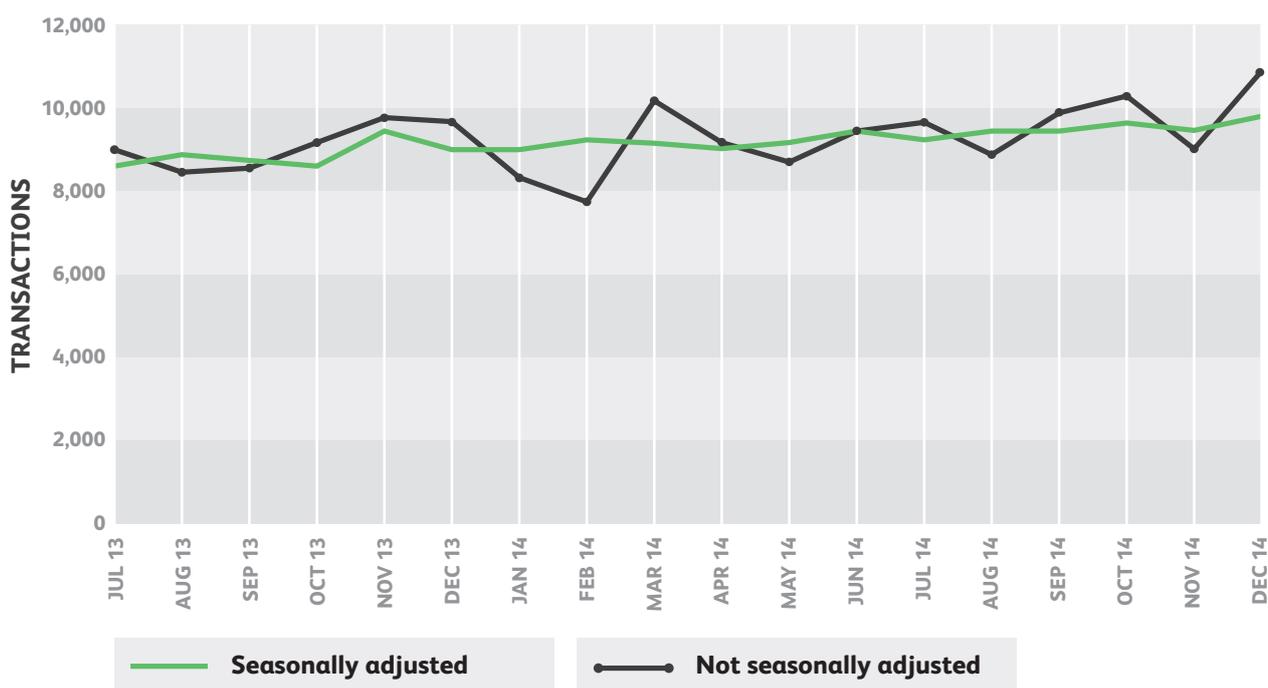
Some issues depend on the size of the organisation. For example, record-keeping for audit purposes is seen as a problem by a fifth of medium-sized firms (50-249), but less of a concern to others. This is likely caused by the fact that medium firms

handle a larger volume of transaction than small entities, but are less likely to invest in advanced record keeping technology than larger firms.

Despite all of these challenges, it's a good time to be a commercial property solicitor. Over half (60%) of our respondents said the volume of transactions they worked on has increased since the beginning of the tax year, and 53% expected this volume to increase in the next 12 months. Only 5% experienced a decrease in volume, and just 2% predicted a decrease in the future. This is in line with HMRC's national findings which indicate a steady increase in the volume of commercial property work.

Firms with more than 250 employees were far more likely (72%) to have experienced an increase than smaller firms, particularly those with fewer than 50 employees (51%). There was a corresponding trend in positivity of outlook for the future. Smaller firms looking to increase the volume of transactions

Total UK Non-Residential Property Transactions



Source: UK Property Transaction Statistics, HMRC, 21 January 2015

therefore need to work hardest to identify new opportunities, such as positioning themselves as trusted advisers on capital allowances.

Growing complacent

So how does the volume of work relate to capital allowances? Our research shows that past increases in the volume of work make some solicitors complacent towards the topic of capital allowances, and that solicitors who displayed this attitude were more likely to expect slowing growth further down the line, even when they have seen rapid growth previously. On the other hand, firms that were least likely to have seen increasing volume of work expressed much more interest in capital allowances. This lack of interest among high-performing firms is a concern as it indicates that many strong performers are exposing themselves to risks associated with ignoring the new legislation.

Solicitors do not understand capital allowances legislation or their enhanced responsibility

Our research highlights varying levels of understanding and knowledge of the new legislation. Even though assessing the capital allowances position is an obligation of the solicitor, many solicitors have retained the mind-set that capital allowances assessments are the responsibility of an accountant, or of the buyer/seller themselves. Only one third believe that any solicitor is responsible. In some large firms solicitors felt that the property agent also has a role to play.

Q. Whose responsibility do you believe it is to ensure the capital allowances position of the property has been assessed?

(Please select all that apply)

The seller's accountant	62%
The purchaser's accountant	60%
The seller	53%
The purchaser	47%
The purchaser's solicitor	37%
The seller's solicitor	32%
The property agent	9%
Another department in my organisation	2%
Other	2%
No one	0%
Don't know	3%

Base size: 219



This is likely because solicitors are not secure in their knowledge of capital allowances legislation, as introduced in 2012. In fact, only one in five stated 'I know everything I need to know about the changes to the FA 2012 and the impact of those changes on commercial property transactions', whilst 70% admitted they would like to know more. Respondents in large firms were twice as likely to state that their level of knowledge was sufficient than those in medium or small size firms. Those employed in large firms were also much more likely to say that it's not their job to deal with capital allowances, perhaps representing a greater division of responsibilities within their specialist departments. Within the smallest organisations only 12% of respondents said they had all the capital allowances knowledge they required.

As a consequence, clients' needs are not served adequately

Although in most cases clients ask for advice (44% of clients ask for advice in completing CPSE.1 V3.4 for example), firms rarely provide personal assistance in completing the crucial Section 32.

"The main difficulty that we are encountering (...) is that clients are coming to transactions with no information at all in relation to capital allowances."

Associate in a large practice in the North West

"I have been on a number of talks about capital allowances and read articles. All have talked around the subject but none have explained clearly what we should do in different scenarios. I feel that clear practical guidance is lacking."

Partner in a small practice in the Midlands



The changes introduced in the Finance Act 2012 have resulted in a revision of the general pre-contract enquiries for all commercial property transactions, CPSE.1.

Most (82%) survey respondents would offer some advice in completing CPSE.1 V3.4, whether or not it was asked for, however, equally many (81%) would refer clients to other experts when completing Section 32.

Although 43% are likely to ask clients to instruct a capital allowances specialist, a worrying 27% would only alert the client to the importance of this section and not get involved themselves. Furthermore, only 2% take the initiative to instruct the capital allowances specialist which indicates

that solicitors often delegate the responsibility to the client. Of course, 64% of respondents ask the client to instruct an accountant, but unless the accountant has relevant capital allowances expertise they won't be able to provide adequate assistance.

It is clear that there are significant areas for improvement in client care here, particularly because if a solicitor recommends an accountant rather than a specialist they are unlikely to identify all the opportunities for clients to claim tax relief. Taking a greater role in the process also enables solicitors to be in greater control of the process – particularly in terms of managing delays – and develop valuable in-house expertise.

Q. How does your firm ensure accurate completion of Section 32?

(Please select all that apply)

We ask the client to instruct an accountant	64%
We ask the client to instruct a capital allowances specialist	43%
We alert the client to do it but do not get involved	27%
We have developed in-house knowledge	14%
We use standard guidance from HMRC	8%
We instruct an accountant	7%
We use standard guidance from other providers	6%
We instruct a capital allowances specialist	2%
Other	3%
Don't know	8%

Base size: 219



Small firms are more likely to advise the accountant option (70% vs. just half of large firms). On the other hand, they are less likely to have developed in house knowledge (3% vs. 36% in large firms). This is unsurprising as smaller practices have limited resources and therefore are less able to develop in-house expertise to deal with capital allowances.

Whether acting on behalf of the purchaser or the seller, solicitors need to stay involved in the process and guide their client to ensure that the client doesn't lose the tax relief and doesn't pay unnecessary tax.

A large proportion of firms rarely produce a form of election notice, whether they are acting on behalf of the seller or buyer.

The introduction of the mandatory pooling requirement dictates that a purchaser is unable to claim any capital allowances on fixtures within a property unless the vendor has first brought the costs, and then a disposal value, into their tax computations.

This means that it is essential for solicitors to produce a form of election notice (S198/199 CAA 2001), in order to ensure that their client gains the best financial position possible following the transaction, 28% of respondents acting on behalf of the purchaser and 25% of solicitors acting on behalf of the seller said they never produce a form of election notice.

Mark Tighe, managing director of Catax Solutions points out, "Currently we see elections being completed in a small percentage of cases. Furthermore, plant and machinery are often given a value of a £1, which we know is wrong due to the amount of claimable items within the average commercial property. This means a large percentage of elections are being completed incorrectly".

Around a third said they produce a form of election notice in up to a quarter of cases, and both 15% of those acting on behalf of the buyer

and 16% of those acting on behalf of the seller admitted they didn't know if the form of election notice was being produced.

The lack of an election notice form poses a risk to the buyer and the seller. Even though there may still be an opportunity for the seller to claim if an election isn't entered into, the buyer will not be able to claim in line with the mandatory pooling requirement. Furthermore, for the seller to claim it is highly likely they will need to do so prior to the sale of the property or they will need the approval of the new owner. In the case of the latter, the new owner's approval is necessary to conduct a survey, as well as to allow access to the property before any alterations take place.

Although it is always better if the solicitor is involved early on in the process, they can play a valuable role whatever the stage at which they are brought in, because they ultimately complete the appropriate paperwork which secures the ability to claim.

Our research shows that small firms are least likely to produce a form of election notice in any transaction. This is not surprising as smaller firms have less resource to handle what may seem a complex matter. Unfortunately, avoiding the topic of capital allowances exposes them to numerous risks, from having unpleasant conversations with clients, through loss of business to potential litigation.

Overall, only 46% of all solicitors responding to the survey believed that it is their responsibility to propose a S198/199 CAA 2001 election in every transaction, whereas 23% thought it was their responsibility to do so only when it has been requested by the client and/or their advisers. Some admit they don't know when it's their responsibility to propose it. This lack of understanding is alarming, as it means many solicitors are depriving their clients of a valuable form of tax relief available to them.

Solicitors need to educate unaware clients

The fact that a third of solicitors (34%) are not being instructed before a sale price has been agreed and that a further 58% are rarely approached before the sale price has been agreed suggests that clients are unaware of how solicitors can help them. Indeed, almost half of those in small firms have never had a client instruct them before the sale price was agreed (43%). Only 4% of respondents stated that they were instructed before the sale price agreement more than half the time.

This is compounded by the fact that clients rarely raise the issue of capital allowances, with 40% of respondents saying that their clients never do it. Again, only 5% of respondents stated that clients raise the issue more than half the time. Those findings highlight just how important it is for solicitors to recognise their responsibility as clients are not going to

do it for them. Raising the point early is essential as it allows sufficient time for the necessary discussions to take place between the client, the accountant and the capital allowances specialist.

The result of this is undoubtedly that clients are not getting the tax relief they are entitled to. In most of the respondents' transactions, capital allowances were allocated after the sale price had been agreed. More than half (52%) stated that the allocation was never decided prior to the agreement of a sale price, whilst a further 36% replied that it was rarely decided prior.

Our research further suggests that clients are more focused on achieving the benefits derived from business continuity and see any delay as costly.

Solicitors need to realise that educating clients on capital allowances and working with them doesn't have to pose any significant risks to the transaction. On the contrary, lawyers can assist their clients in making significant tax savings. The table on the next page provides an estimated value of savings for different levels of property prices.

"Buyers are just as disinterested even when advised that capital allowances will be lost forever if they are not dealt with on a sale. They are far more interested in getting the deal done and the work and cost required to deal with capital allowances is perceived as a cause of delay rather than a longer term benefit."

Managing partner in a small practice in the Midlands

"It is essential that the solicitor is engaged as early as possible in the process; clients need to be made aware of the potential benefit of claiming capital allowances and determine their availability."

Mark Tighe

Managing Director of Catax Solutions
The Law Society's endorsed capital allowances partner





Estimated value of savings

Property Purchase Price	Capital Allowances Available 25%	Corporation Tax Savings at *20%	Income Tax Savings at 20%	Income Tax Savings at 40%
£400,000	£100,000	£20,000	£20,000	£40,000
£500,000	£125,000	£25,000	£25,000	£50,000
£600,000	£150,000	£30,000	£30,000	£60,000
£700,000	£175,000	£35,000	£35,000	£70,000
£800,000	£200,000	£40,000	£40,000	£80,000
£900,000	£225,000	£45,000	£45,000	£90,000
£1,000,000	£250,000	£50,000	£50,000	£100,000
£1,500,000	£375,000	£75,000	£75,000	£150,000
£2,000,000	£500,000	£100,000	£100,000	£200,000
£2,500,000	£650,000	£125,000	£125,000	£250,000
No Upper Limit	25% is typical but amounts may vary. The majority of this figure is written down within 5 years	These are the Corporation Tax savings, if the property is owned by a Ltd Company*	These are the Income Tax savings, if the property is privately owned e.g individual, partnership and paying 'basic rate'	These are the Income Tax savings, if the property is privately owned e.g individual, partnership and paying 'higher rate'

* Tax rate subject to change based on HMRC. All figures are for presentation purposes only and are non-contractual.

Furthermore, with an average conveyancing transaction taking three months (over four months for the largest transactions), there is more than enough time to address the issue of capital allowances if all parties begin early. Raising the topic of capital allowances, at an early stage, is also important as it helps deal with two major challenges solicitors face: buyers' inability to secure financing and last-minute demands from clients.

Mark Tighe, managing director of Catax Solutions explains:

"Thanks to the relationship with the Law Society we have been able to implement a procedure that allows us to prioritise cases with pending transactions. In fact, we have a team working on the most urgent transactions who have recently completed a case on a £48million property in eight days which demonstrates how quickly they work."

Many question the benefits of improving their capital allowances knowledge or service

When asked about their compliance with the new legislation, for example in terms of introducing suitable procedures, only 57% stated they have made a reasonable or a significant amount of progress. 35% have made limited progress, while 8% have made none. Large firms were more likely to claim a good amount of progress, with 29% reporting a 'significant amount' compared to just 6% of those in small firms.

This low interaction with the practicalities of the legislation was perhaps because three quarters of respondents believed that it brought no benefits to their firm. Furthermore, over a third of respondents identified risk of litigation, administrative burden and loss of efficiency as disadvantages brought about by the legislation.

Some respondents also thought that the costs of undertaking capital allowances work would outweigh the benefit. This is untrue in all but the most unusual circumstances and our analysis shows that even for properties worth as little as £250,000 it pays to seek tax relief. Furthermore, even if the client is unconvinced of the benefit, it is the solicitor's duty to raise the issue of capital allowances and to contact a capital allowances specialist.

So what is the total estimated value of unclaimed capital allowances? Our analysis based on transaction volumes between 1 April and 31 December 2014 (85,080 non-residential transactions) and the average sale price of £4,720,751 shows that buyers and sellers have missed out on an opportunity to claim over £1.6 billion.

"Solicitors are expected to advise on [capital allowances], without training (which is more pertinent to accountants) and at no extra cost to the client."

Solicitor in a medium practice in the South East

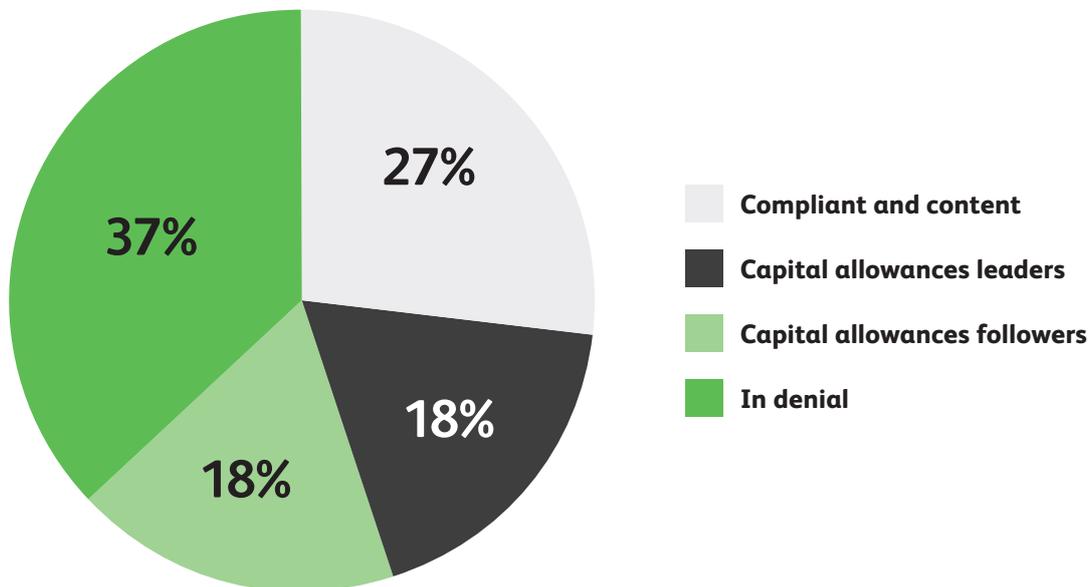




Those who are in denial are in the minority

While some respondents claim that the new legislation has no advantages and presents a significant administrative burden, others are embracing it and seeing the benefits. Using responses to a group of questions we have classified respondents into four types:

Adoption of the new capital allowances legislation



Compliant and content (27%)

Compliant and content respondents, which make up just 27% of those surveyed, feel that it's the solicitor's responsibility to ensure the capital allowances position of the property has been assessed and they see some commercial benefits of this work. However, they are unlikely to take any further action in relation to capital allowances. This is because they are satisfied with the level of in-house knowledge they have developed. Many of them have also built / strengthened their relationships with professional services firms as a result of the new legislation, which they see as a benefit of the new regulation.

Capital allowances leaders (18%)

Capital allowances leaders agree that it's their responsibility to ensure the capital allowances position of the property has been assessed and they are likely to take further action in relation to ensure adoption of the new rules. They tend to be hands on and let the client know that they should instruct a capital allowances expert.

Capital allowances followers (18%)

Capital allowances followers don't yet realise that it's the solicitor's responsibility to ensure the capital allowances position of the property has been assessed, but they are likely to take action in relation to capital allowances if they receive more guidance and get a better understanding of how capital allowances could be a profitable line of work. They often admit that they don't know what the benefits and challenges of the new regulation are. Most of them have made limited or no progress in ensuring compliance with the new legislation.

In denial (37%)

37% of respondents feel that it's not the solicitor's responsibility to ensure the capital allowances position of the property has been assessed, and they are unlikely to take any action in relation to ensuring compliance with the new legislation. They tend to be concerned about the new regulation decreasing the efficiency of their conveyancing processes, and therefore they are less likely than "leaders" or "followers" respondents to ask the client to instruct a specialist.



Determining capital allowances – process outline

Acting on behalf of the purchaser

1. Raise the topic of capital allowances as early in the transaction as possible. This will allow sufficient time for the necessary discussions between the seller, their accountant and their capital allowances specialist.
2. Obtain a full response to section 32 of the CPSE.1
3. Once you have received a response seek advice from capital allowances specialist.

Where the seller has claimed full capital allowances

4a. Request full details of which fixtures have been claimed on, the total amount added to the pool, and the current residual value of the claim.

5a. Negotiate the level of capital allowances to be passed to the buyer.

Where the seller has not claimed capital allowances

4b. Establish whether or not the seller is eligible to claim. If the seller is a non-taxpaying entity (such as a charity or a fund), the new requirements may not apply.

5b. If the pooling and fixed value requirements apply, it is the purchaser's interest to enter into capital allowances provisions in the agreement. This will allow the purchaser to enjoy the benefit of the unclaimed capital allowances disposed to them by the seller.

Acting on behalf of the seller

1. Work with the seller, the accountant and the capital allowances specialist to ascertain whether all available allowances have been pooled appropriately.
2. Negotiate the final allocation of allowances - allowances can be retained in full or part by the seller or entirely transferred to the new owner
3. Respond to section 32 of the CPSE.1
4. Complete an s198 election notice to reflect the position

Conclusions

There is a clear opportunity for solicitors from capital allowances.

Solicitors' obligations when working on commercial property transactions have changed since April 2014. They now have a duty to ensure that capital allowances are correctly determined.

However, many in the profession are not fully up to speed with their new obligations, and are exposing themselves to risks ranging from loss of fee income to litigation. Very few commercial property transactions giving rise to capital allowances appear to be handled in line with best practice. This is not merely a matter of risk to the profession. It's a missed opportunity to build expertise, relationships and new business.

There are reasons for this reticence. Solicitors often lack crucial information from clients and worry about administrative costs and delays. Small practices often struggle to invest in the in-house expertise required. More importantly, a revived commercial property market may have fostered complacency among part of the profession.

However, all of the above can be overcome. The process for determining allowances can be tailored to transactions requiring a very quick turnaround, which are in any case rare. Small practices can build strategic partnerships with other professionals in order to provide clients with a more comprehensive service.

Positively, our research shows that a significant share of solicitors now want to know more about capital allowances. This has been demonstrated by the fourfold increase in technical queries Catax Solutions have experienced since the implementation of the legislation on 1st April 2014. Through our partnership with Catax Solutions, the Law Society offers its members access to the information and advice they need.



The Law Society

Act now! Understand the legislation and seize the opportunity

Catax Solutions, as the Law Society's endorsed capital allowances partner, can give you the knowledge and support you need to fully understand your responsibilities in the property transaction process, and advise you on the steps you need to take to implement effective procedures. Law Society members can register for free at the Catax Solutions Portal for access to our capital allowances helpline, and to legislation and policy information.

For more information about capital allowances contact:

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Research methodology

Research was conducted in January 2015 with 219 solicitors involved in commercial property transactions. Research attracted 58 respondents from large, 62 respondents from medium and 98 respondents from small organisations.

For further details about this research please contact:

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