REPLYING TO CPSE.1 ENQUIRY 32 ON CAPITAL ALLOWANCES

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This practice note provides a guide to replying to CPSE.1 Enquiry 32 on capital allowances.

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CONTENTS

Capital allowances provide tax relief to businesses investing in qualifying assets, reducing the amount due in corporation tax (for companies) or income tax (for sole traders and partnerships). They are available to owner-occupiers and investors (that is, landlords). Many commonplace assets in business premises are eligible for capital allowances.

Particular attention is drawn to Enquiry 32.10. The tax savings arising from capital allowances can be significant. This makes it important to establish that the claim for capital allowances can be made and whether there may be any restrictions on the amount that may be claimed. Steps may be needed before or soon after the sale, in order to safeguard the ability to claim.

Solicitors/conveyancers may wish to recommend at the outset that their client should consult a suitably qualified and experienced specialist capital allowances adviser, or other competent tax practitioner. Armed with high-level information about the Property and the responses to CPSE.1 Enquiry 32, that expert should be able to recommend such further enquiries as are necessary, together with appropriate steps to safeguard the anticipated tax savings or the Buyer may wish to adjust the price it has offered for the Property, if its anticipated claim for capital allowances is in doubt.

If the Seller fails to answer, or gives the answer "not applicable" (or its equivalent), this merits further investigation. Such a response will rarely be appropriate. Ask the Seller to explain why that response was given.

Capital allowances on plant and machinery

CPSE.1 Enquiry 32 focuses on a type of capital allowances called "plant and machinery allowances". The relevant legislation is mostly contained in the Capital Allowances Act 2001 (CAA 2001).

Plant and machinery allowances are only available for capital expenditure on "plant" and "machinery". Both fixtures and chattels may be plant or machinery, but CPSE.1 Enquiry 32 is concerned only with fixtures.

Chapter 14 of CAA 2001 contains a special set of rules for fixtures. These rules are written in the singular tense, so work on an individual asset-by-asset basis (that is, "a fixture"). A fixture is defined as plant or machinery *"... that is so installed or otherwise fixed in or to a building or other description of land as to become, in law, part of that building or other land" (section 173, CAA 2001).*

Therefore, it takes its meaning from the law of real property. It also includes *"any boiler or water-filled radiator installed in a building as part of a space or water heating system"*. Among other things, the fixtures rules can deem a fixture to belong to someone (such as a tenant) for capital allowances purposes only, even if it does not actually belong to them in real estate law. This statutory fiction permits the deemed owner to claim capital allowances for expenditure on that fixture (see *CPSE.1 Enquiry 32.5* below).

Machinery is not defined in statute so it takes its ordinary, natural meaning. However, identifying plant is more complicated. In some cases it is defined by statute. For example, section 33A of CAA 2001 defines "integral features" that qualify for plant or machinery allowances. Integral features comprise electrical systems (that is, power and lighting); cold water systems; hot water and heating systems; ventilation and air conditioning systems; lifts, escalators and moving walkways; and external solar shading. Otherwise, plant is defined by case law. In essence, plant is "apparatus" (that is, equipment or tools) used by a business. In practice, this includes many ordinary fixtures within business premises, such as: sanitary appliances (basins, sinks, WCs and the like), fire alarms and sprinklers, burglar alarms and CCTV systems, telecommunications and data installations, moveable partitions (meeting certain conditions), and some built-in joinery fittings.

Plant and machinery allowances may be claimed if all of the following conditions are met:

- The claimant has incurred capital expenditure (see *CPSE.1 Enquiry 32.1* below).
- That expenditure is on the provision of plant or machinery fixtures.
- That expenditure was for business purposes (that is, a "qualifying activity" within section 15 of CAA 2001.)
- As a consequence of incurring that expenditure, the claimant owns (as defined for capital allowances purposes) the fixture(s).

(*Section 11, CAA 2001.*)

Capital allowances are available at varying rates for different types of plant and machinery as follows:

- A writing-down allowance (WDA) of 8% a year on a reducing balance basis (that is, a fixed percentage of the written-down value of the asset, rather than a fixed annual amount) for "special rate assets".
- A WDA of 18% a year on a reducing balance basis for "main pool assets".
- A 100% a year annual investment allowance (AIA) for plant and machinery up to a maximum annual limit, which is currently £500,000 (increased from £250,000 by section 10 of the Finance Act 2014).

CPSE.1 ENQUIRY 32.1

Do you hold the Property on capital account as an investor/owner-occupier, or on revenue account as a developer/property trader as part of your trading stock? Please specify which.

It is crucial to establish whether the Seller's expenditure on buying or building the Property is classified as capital expenditure or revenue expenditure for tax purposes. These are mutually exclusive. Expenditure is either capital or revenue; it cannot be both. If the Seller's expenditure was revenue expenditure, the Seller cannot claim plant and machinery capital allowances because these are only available for capital expenditure.

If the Seller's expenditure is revenue, it cannot enter into a section 198 or 199 of CAA 2001 election to establish a disposal value (see *What is a disposal value?* below) for plant and machinery fixtures (see *CPSE.1 Enquiry 32.9 (www.practicallaw.com/7-575-0610)*).

What is a disposal value?

A disposal value is sometimes called a disposal receipt or disposal proceeds. The Seller has a mandatory obligation to account for disposal proceeds in its tax return in respect of all qualifying expenditure that it has pooled (see *What does pooling mean?* below). The disposal value is a negative adjustment (that is, subtraction) from the Seller's pool to reflect the value that the plant and machinery fixtures are considered to be worth for capital allowances purposes at the time of sale. In other words, the price which the Buyer is paying for those plant and machinery fixtures for capital allowances purposes.

CAA 2001 contains detailed rules setting out how a disposal value must be calculated. For most sales these require a just and reasonable apportionment (see *What is a just and reasonable apportionment?* below) of the sale proceeds (under section 562 of CAA 2001). Additionally, the just and reasonable apportionment cannot exceed:

- The qualifying expenditure originally pooled by the Seller (*section 62 (www.practicallaw.com/5-575-1026)*, CAA 2001).

- The disposal value for those fixtures on sale, brought into account by a previous owner of the Property since 24 July 1996 (*section 185, CAA 2001*).

Instead of relying on a just and reasonable apportionment, the Seller and Buyer may agree their own apportionment for the fixtures by jointly making a section 198 of CAA 2001 election (or, on the grant of a lease, a section 199 of CAA 2001 election). However, the amount apportioned to the fixtures cannot exceed the amounts referred to in sections 62 and 185 of CAA 2001 (see above).

Establishing the type of expenditure

Establishing whether a property owner's expenditure is capital or revenue involves considering a range of factors, including the so-called "badges of trade" (for example, length of ownership, frequency of transactions and the like), which term arises from an old Royal Commission report on the taxation of profits that reviewed the relevant case law. There are no hard and fast rules.

Seller's intention

The key factor is the Seller's motive for acquiring the Property (that is, what was its intention when it built or bought the Property).

If the Seller's intention was to sell the Property relatively quickly, or re-develop the site and sell it, the cost will generally be treated as revenue expenditure. This can be so even if the sale does not happen for a few years.

However, if the Seller's intention was to hold the Property longer-term with a view to using it in its business (own occupation), or earning rental income from it, or to benefit from an investment gain (investment), the Seller's expenditure would usually be treated as capital. That can remain the case, even if an offer that is "too good to be refused" results in a quick sale.

Classification in the accounts

Usually the Seller's financial accounts show:

- Capital expenditure as a fixed asset on the balance sheet.

- Revenue expenditure as a current asset on the balance sheet or expensed, as a running cost of the business, in the profit and loss account.

Advice from Seller's accountant

The Seller's accountant ought to be able to confirm which class of expenditure applies, even if it is unclear from the accounts.

A trader's expenditure is not all revenue

The terminology used in this enquiry sometimes causes confusion because a business which, for example, makes or sells things with a view to a profit is referred to in tax jargon as a "trade" (rather than "investment") and in practice such businesses are often described as "traders". However, if they hold property for their own-

occupation, or rent it out, then their expenditure to develop or buy that property is capital (that is, incurred on investment account) and not revenue (that is, not incurred on trading account).

Contrast the expenditure incurred by a developer (who develops property with a view to sale) or a property dealer (who buys property with a view to making a quick return by selling it on). This would normally be revenue expenditure for tax purposes.

Enquiry answers

If the Seller's expenditure is capital, an acceptable answer to this enquiry would be "capital account" (or perhaps "The Seller holds the Property as an investment" or "fixed asset").

If the Seller's expenditure is revenue, an acceptable answer would be "revenue account" (or perhaps "The Seller holds the Property as a trading asset" or "current asset").

Unacceptable answers include "not applicable", "don't know", "yes", "no", "accountant to advise", or "Buyer should make their own enquiries".

CPSE.1 ENQUIRY 32.2

Have you claimed capital allowances on plant or machinery fixtures or allocated any expenditure on such fixtures to a capital allowance pool? If so, please answer the supplementary questions in enquiry 32.9 in respect of that expenditure.

Enquiry 32.1 should establish whether the Seller *could* have claimed plant and machinery capital allowances for fixtures at the Property (assuming that the Seller is a taxpayer). Enquiry 32.2 looks to establish whether the Seller actually made such a claim or pooled the expenditure on the plant and machinery (a preliminary step to claiming).

What does pooling mean?

Claiming plant and machinery capital allowances is a two-stage process:

- **Stage one:** The expenditure is "pooled". This means that the qualifying expenditure:
  - is added to (that is, recorded in) a tax ledger with other assets which have similar characteristics for tax purposes; and
  - is included in the claimant's tax return.
- **Stage two:** The Seller actually claims the tax relief on that qualifying expenditure either by claiming a WDA or AIA (see *Capital allowances on plant and machinery* above).

"Pooling" tells HMRC that the business has spent money on those qualifying items. All of the Seller's special rate expenditure is pooled together, even if the assets are located in different properties. Likewise with main pool expenditure. Once qualifying expenditure has been pooled it is not obligatory to go through with the second step and claim the tax relief. The Seller is free to choose not to claim the tax relief in any year. This is called "disclaiming" the allowances.

If the Seller has pooled any expenditure on plant and machinery fixtures (whether it has claimed relief or not), the amount of expenditure on such plant and machinery on which the Buyer can claim capital allowances may be capped. It is important that the Buyer understands the limits on any claim it (or its successor in title) may submit. If these limits reduce what the Buyer was expecting, and on which it based its offer for the Property, it may want to adjust the price offered.

This enquiry is designed to find out whether the Seller has claimed the allowances, or if not, has pooled the expenditure. If the Seller has pooled the expenditure, the supplementary questions in Enquiry 32.9 (see *CPSE.1 Enquiry 32.9* below) will help to establish whether there is a cap on the capital allowances that the Buyer could claim.

Enquiry answers

An acceptable answer to this enquiry is "yes" or "no". If the answer is "yes", Enquiry 32.9 should also be completed.

Unacceptable answers include "not applicable", "don't know", "accountant to advise", or "Buyer should make their own enquiries".

CPSE.1 ENQUIRY 32.3

If you have not pooled any expenditure on plant or machinery fixtures:

- **will you do so if the Buyer asks you to?**
- **if so, by when?**
- **if not, why not?**

Pooling requirement

The Finance Act 2012 inserted sections 187A and 187B into CAA 2001. These sections introduced the pooling requirement, which applies if both of the following conditions are met:

- The sale takes place on or after 1 April 2014 (for corporation tax) or 6 April 2014 (for income tax).
- The Seller (or any previous owner who has owned the Property since April 2014) could have pooled qualifying expenditure on plant and machinery fixtures (irrespective of whether it actually did so). Broadly, that means circumstances where the Seller (or previous owner) is an owner-occupier or investor (who incurred capital expenditure: see *CPSE.1 Enquiry 32.1* above) and is subject to tax.

The pooling requirement does not apply if the Seller and previous owners since April 2014 were not within the charge to tax (for example, a charity, pension fund or local authority).

In addition, the pooling requirement does not apply in relation to particular fixtures (relevant fixtures) in the following circumstances:

- The Seller and previous owners since April 2014 were only able to claim capital allowances in respect of the relevant fixtures because they had contributed towards another person's expenditure (*section 187A(1)(c), CAA 2001*). For example, a landlord paying some or all of the cost of a tenant's plant (see sections 537 and 538 of CAA 2001 and *CPSE.1 Enquiry 32.5* below).
- The Seller and previous owners since April 2014 could not have claimed allowances in respect of the relevant fixtures because the relevant fixtures would not have been treated as plant in their hands. For example, if the Seller incurred expenditure on cold water, general electrical power and lighting, or external shading before April 2008 (so-called "pre-commencement integral features"), such expenditure would generally not have been expenditure on plant in the Seller's hands; only expenditure on such items of plant incurred after 1 or 6 April 2008 would qualify as plant (the date that section 33A of CAA 2001 first designated these assets as plant in all circumstances).

Seller and all previous owners since April 2014 could not pool expenditure

If the Seller and any previous owners since April 2014 have incurred expenditure on plant or machinery fixtures but none were entitled to pool that expenditure, the Buyer's claim for capital allowances on those fixtures is calculated on a "just and reasonable apportionment" (see *What is a just and reasonable apportionment?* below) of the price paid by the Buyer for the Property (*section 562, CAA 2001*), subject to any limitation under section 185 of CAA 2001. It is neither necessary, nor possible, to agree a section 198 of CAA 2001 election with the Seller stating the apportioned figure, nor to apply to the First-tier Tribunal to determine the apportioned figure. Once the relevant apportionment is determined, the Buyer can make a claim for the capital allowances if it pools that expenditure and makes a claim for the allowances in its tax return (see *What does pooling mean?* above).

What is a just and reasonable apportionment?

Only part of the price paid for a property attracts capital allowances. In particular, the price attributable to the land never attracts allowances and, since the withdrawal of industrial buildings allowances, expenditure attributable to the building does not normally attract capital allowances. Therefore, it is necessary to apportion the price paid for the Property between those elements qualifying for allowances (plant and machinery fixtures) and those that do not.

A "just and reasonable" apportionment of the price under section 562 of CAA 2001 is a specialist valuation for capital allowances purposes and is usually prepared by a capital allowances adviser. Section 562 does not prescribe the method of apportionment. The value arising from a just and reasonable apportionment can be counter-intuitive. As established apportionment methods use a land value and replacement costs of the building and qualifying assets to establish an appropriate qualifying proportion of the price, the amount that plant or machinery fixtures are worth for capital allowances purposes will usually greatly exceed the value that "common sense" might otherwise suggest would be appropriate.

Seller could have pooled expenditure on plant and machinery fixtures but has not done so

If the Seller could have pooled its expenditure on a plant and machinery fixture or fixtures, the pooling requirement dictates that before the Buyer is able to claim plant and machinery allowances for those fixtures, the Seller must first pool its qualifying expenditure in its own tax return. The Seller's qualifying expenditure is the capital expenditure

incurred by the Seller on those plant and machinery fixtures when it built, bought or refurbished the Property.

If the Seller does not pool its qualifying expenditure, the Buyer will be deemed to have paid nothing for those plant and machinery fixtures. It will be unable to claim any plant and machinery capital allowances on those fixtures and its successors in title will not be able to claim either. This may reduce the price at which the Buyer can sell the Property.

To avoid this, the Buyer should ask the Seller to pool its qualifying expenditure. The Buyer could make performance of this obligation a pre-condition to exchange, or to completion of the sale. Doing so avoids the risk that the Seller fails to pool after completion, leaving the Buyer unable to claim the anticipated capital allowances. This might happen if the Seller becomes insolvent, dies (being an individual), moves abroad or otherwise fails to comply with its contractual obligations.

Pooling can be done either by the Seller:

- Amending a tax return that has already been submitted.

- Making the necessary entries on its next tax return. This could occur before exchange, between exchange and completion or after completion of the sale (depending on when the normal time for submission of the next return occurs).

The Seller's chargeable expenditure must be pooled in a chargeable period "beginning on or before the day on which the past owner [that is, the current Seller] ceases to be treated as the owner of the fixture [that is, sells the fixture], or a first year allowance has been claimed in respect of that expenditure (or any part of it)" (*section 187A(4), CAA 2001*).

In theory, because of the normal self-assessment timescales to claim capital allowances, the Seller's expenditure could be pooled up to three years after completion of the sale. However, once the expenditure has been pooled by the Seller, the fixed value requirement (see *Fixed value requirement* below) applies (see *CPSE.1 Enquiry 32.9* below) and that must be satisfied within two years of completion of the sale.

Therefore, it is strongly recommended that the Seller should be required to pool the expenditure as soon as is reasonably practicable and certainly no later than two years from completion of the sale.

Once the expenditure has been pooled by the Seller, the fixed value requirement applies in the normal way (see *CPSE.1 Enquiry 32.9* below).

If the Seller agrees to pool its plant and machinery fixtures expenditure (and does in fact do so), the fixed value requirement will need to be met before the Buyer can claim allowances. If the Seller agrees to pool its expenditure, in practice, it is likely that the Seller and Buyer will also agree to make a section 198 of CAA 2001 election to satisfy the fixed value requirement. If an election is proposed, the Buyer's interests will be best served by the election amount being the full amount of expenditure pooled in respect of each fixture. However, the flexibility exists to agree a different amount (to the disadvantage of the Buyer). This is discussed in relation to enquiry 32.9 (see *CPSE.1 Enquiry 32.9* below).

HMRC has the right to challenge capital allowances claims. The Buyer may wish to insist upon the right to manage any HMRC compliance check into the Seller's pooled expenditure, as it will normally be the Buyer that has the greater interest in ensuring that the maximum amount possible is pooled. The Seller and the Buyer should also agree on who will pay the professional costs of dealing with any dispute with HMRC. It would probably be reasonable for the costs to be borne by whoever obtains the benefit.

Seller could not pool its expenditure but previous owner since April 2014 could have pooled its expenditure

If the Seller could not pool its expenditure but a previous owner since April 2014 could have done, the Buyer will want to know whether that previous owner did in fact pool that expenditure. Enquiry 32.4 addresses this.

Enquiry answers

If the Seller has already pooled all expenditure (as indicated by a yes answer to Enquiry 32.2), an acceptable response to all limbs of Enquiry 32.3 is "not applicable".

If the Seller has not pooled its expenditure:

- Enquiry 32.3(a): An acceptable answer is either "yes" or "no".

  It is possible that the Seller may answer "yes" to Enquiry 32.2 (see *CPSE.1 Enquity 32.2* above) in respect of some fixtures, but that the Property also

contains other fixtures upon which the Seller was entitled to claim but did not do so. If the Seller is aware that this is the case Enquiry 32.3(a) should be answered "yes". However, in most cases where there has been a partial claim the likelihood is that the Seller will be unaware that it could have claimed in respect of other fixtures (otherwise they may well have claimed). Therefore, it is unlikely that the Seller will be able to provide any details about those unclaimed fixtures (and expecting the Seller to do so is tantamount to asking "please list everything you are unaware of"). However, armed with the replies to Enquiry 32.2 and 32.9, and some high-level information about the Property, a capital allowances specialist acting for the Buyer should be able to form a view on potential "gaps" in the Seller's capital allowances claim and advise the Buyer appropriately.

- Enquiry 32.3(b): An acceptable answer will require a timescale: for example, a specific date, or a number of days, weeks or months.

- Enquiry 32.3(c): Where relevant, this enquiry requires a brief explanation of why the Seller cannot, or will not, pool its qualifying expenditure (for example, it is outside the charge to income and corporation tax).

Unacceptable answers generally include "don't know", "accountant to advise", "Buyer should make their own enquiries", and "not necessary" or "not required".

CPSE.1 ENQUIRY 32.4

If you bought the Property and cannot pool any expenditure on plant and machinery fixtures:

- **please provide the name and contact details of everyone who has owned the Property since April 2014;**

- **please provide evidence that the most recent previous owner who was entitled to claim allowances pooled any expenditure on plant and machinery fixtures. Please answer the supplementary questions in enquiry 32.9 in respect of that previous owner's expenditure.**

Even if the Seller was not entitled to pool any qualifying expenditure on plant and machinery fixtures, the pooling requirement will still apply if a previous owner (who has owned the Property since 1 April 2014) could have pooled qualifying expenditure on plant and machinery fixtures.

This enquiry seeks the name and contact details of anyone who has owned the Property since 1 April 2014 and evidence of the fact that they did pool capital expenditure on plant and machinery fixtures.

If there was a previous owner who has owned the Property since April 2014 and could have pooled qualifying expenditure but did not do so then it is possible (albeit unlikely) that the Buyer may still be able to satisfy the fixed value requirement (see *Fixed value requirement* below). This could potentially be done by contacting the previous owner and asking them to pool their qualifying expenditure (if they are still permitted to do so within normal self-assessment time limits). However, even when still within time to do so, in practice, it is likely to be difficult to persuade a previous owner to co-operate without providing a financial incentive.

Enquiry answers

If the Seller was entitled to pool expenditure (see *CPSE.1 Enquiry 32.3* above), an acceptable answer is "not applicable".

If the Seller was *not* entitled to pool expenditure:

- Enquiry 32.4(a): An acceptable answer will provide the name and contact details of anyone known to have owned the Property since April 2014. The Seller will know the details for its immediate predecessor in title. However, it may not have details of any earlier owners (as their details are usually removed from the registered title entries when the next owner applies for registration as proprietor).

- Enquiry 32.4(b): An acceptable answer is to provide evidence that the most recent owner (before the Seller) who was entitled to pool expenditure on plant and machinery fixtures actually did so. If replies to CPSE.1 on previous sales are with the title deeds, it may be possible to use the answers given by the earlier owners to provide that proof, because CPSE.1 has requested details of the capital allowances treatment of the Seller for many years (originally in CPSE.1 Enquiry 19 and now in CPSE.1 Enquiry 32).

The details of any claim made by the most recent previous owner entitled to claim capital allowances on plant and machinery fixtures are requested in Enquiry 32.9.

Unacceptable answers include "don't know", accountant to advise", "Buyer should make their own enquiries" and "not necessary" or "not required".

CPSE.1 ENQUIRY 32.5

Please provide details of any plant and machinery fixtures which were paid for by a tenant, including any contributions made by you towards their cost.

Tenants' fixtures

If a plant and machinery fixture has been installed by a tenant at its expense, and the tenant has an appropriate legal interest in the Property at that time, section 176 of CAA 2001 deems that fixture to belong to the tenant for capital allowances purposes. This means that the tenant is entitled to claim capital allowances in respect of that fixture, and not the landlord.

When the leasehold reversion is sold, the Buyer will not acquire ownership of this fixture for capital allowances purposes and cannot claim capital allowances for any expenditure on it. Ownership of and entitlement to capital allowances on this fixture will remain with the tenant.

Seller's contributions to cost of tenant's fixtures

If the Seller has paid for some or all of a tenant's plant or machinery (chattels or fixtures), the Seller may have been able to claim capital allowances in respect of that expenditure under the "contributions" rules set out in sections 537 and 538 of CAA 2001. If the seller has pooled that expenditure, it would have been allocated to a single asset pool (that is, a pool containing only the expenditure on the plant and machinery attributable to the contribution) (*section 538(3), CAA 2001*). As such, the expenditure should be easy to identify. If the seller has made any such contributions, the entitlement to claim capital allowances for expenditure on that plant and machinery will automatically pass to the Buyer on the sale of the reversion (*section 538(4)-(6), CAA 2001*).

Enquiry answers

If the Property has not been let out the appropriate answer will be "not applicable".

Otherwise, where known, details should be given of any such tenant's fixtures and contributions made by the Seller towards their cost.

CPSE.1 ENQUIRY 32.6

Please provide details of any plant and machinery fixtures which are leased to you by an equipment lessor.

Sometimes plant and machinery fixtures at the Property do not belong to the Seller, but are leased under an equipment lease. Common examples are washroom equipment (such as hot air hand dryers) or air conditioning units. In such circumstances, the equipment lessor is usually entitled to claim the capital allowances, and not the Seller.

On a sale of the Property, ownership of these fixtures does not pass to the Buyer (but remains with the equipment lessor). The Buyer cannot make a plant and machinery capital allowances claim for any expenditure apportioned to these fixtures.

Enquiry answers

If no assets are leased under an equipment lease the appropriate answer will be "not applicable".

Otherwise, details of any such leased assets should be provided, where known.

Unacceptable answers generally include "don't know", "accountant to advise", "buyer should make their own enquiries", and "not necessary" or "not required".

CPSE.1 ENQUIRY 32.7

If the transaction is the grant of a new lease at a premium, and you are entitled to do so and the Buyer asks you to, will you enter into a Capital Allowances Act 2001 section 183 election for the Buyer to be treated as the owner of the plant and machinery fixtures for capital allowances purposes?

This question is only relevant if the transaction is the grant of a new lease for a premium (that is, a capital sum); not the sale of a freehold or assignment of an existing lease.

Section 183 of CAA 2001 election

If the Landlord incurred expenditure on plant and machinery fixtures in the Property on which it was entitled to claim capital allowances or would have been if it had been subject to tax, ownership of those fixtures for capital allowances purposes and any capital allowances in respect of that plant and machinery are automatically treated as being retained by the Landlord after the grant of the lease.

However, as long as the Landlord and Tenant are not connected for tax purposes (see below) then they may enter into a section 183 of CAA 2001 election to treat

the Tenant as the owner of those plant and machinery fixtures for capital allowances purposes. This means that the Tenant will be able to claim capital allowances on an apportioned part of the premium paid for the lease.

There are detailed provisions in section 575 of CAA 2001 for determining whether one person is connected with another. Broadly, individuals are connected to each other if they are spouses, civil partners, relatives (brothers, sisters, ancestors or lineal descendants) or are in partnership with someone (including that partner's spouse, civil partner or relative). Companies are connected if the same person has control of both, or someone controls one company and connected persons control the other.

Enquiry answers

If the question is not relevant (because the transaction is not the grant of a lease for a premium) an acceptable answer is "not applicable", or its equivalent.

If the question is relevant, an acceptable answer is "yes" or "no".

Unacceptable answers include "don't know", "accountant to advise", or "Buyer should make their own enquiries".

CPSE.1 ENQUIRY 32.8

Please provide details of any expenditure on plant and machinery that you have treated as long-life assets, or any expenditure upon which you have claimed another type of capital allowances (for example, industrial buildings allowances, research and development allowances, business premises renovation allowances and so on).

The Buyer's plant and machinery fixtures claim may be restricted if the Seller has treated any fixtures as a long-life asset or claimed other types of allowance in respect of the fixtures. As such, it is essential for the Buyer to know about this and specialist capital allowances advice may be prudent.

The first part of the question deals with long-life assets. Long-life assets are plant and machinery fixtures that can reasonably be expected to have a useful economic life, when new, of at least 25 years (regardless of who owns the Property). Long-life assets are one type of "special rate" pool expenditure and are subject to "grandfathering" treatment. This means that if the Seller has treated any plant or machinery as a long-life asset in its tax return, the Buyer is obliged to follow this treatment. Therefore, the Buyer needs to know whether any items have been treated as long-life assets. Several common property types are excluded from long-life asset treatment. These include offices, retail shops or showrooms, and hotels.

The second part of the question deals with a range of other types of allowances that are available for particular building uses, or assets that are not plant or machinery. For example (among others):

- Industrial buildings allowances used to be available (until they were withdrawn from April 2011) for expenditure on industrial buildings or structures. These were in use for various business activities, including: manufacturing, processing, and storing goods and materials for manufacturing or processing purposes. Also included were utility undertakings (for example, electricity, water and sewerage) and transport and highway undertakings. Enterprise zone allowances from the 1980s and 1990s were a special type of industrial buildings allowances for specially designated areas. Hotels meeting certain conditions were also deemed to be industrial buildings.

- Research and development allowances (previously called scientific research allowances) provide tax relief for capital expenditure on facilities and equipment used for research and development.

- Business premises renovation allowances are an urban regeneration measure, given for capital expenditure to renovate business premises and bring those premises back into use.

Enquiry answers

The Seller or the Seller's accountant should know if another type of allowance has been claimed.

If none of the fixtures are long-life assets and none of these other allowances has been claimed, an acceptable answer is "not applicable", or its equivalent.

If one or more fixtures are long-life assets or some of these other allowances have been claimed, an acceptable answer is to provide details of that previous claim (for example, the type of capital allowance claimed, the amount of qualifying expenditure, and when this was incurred).

CPSE.1 ENQUIRY 32.9

For each plant and machinery fixture for which a claim has been made or expenditure has been pooled, please:

- **provide a description of that fixture;**
- **state when that fixture was acquired;**
- **state whether that fixture was installed by you, or already installed by a previous owner (please specify which);**
- **state the amount of expenditure pooled in respect of that fixture; and**
- **(where enquiry 32.2 applies) confirm that you will enter into a Capital Allowances Act 2001 section 198 election in that amount (or other appropriate amount, to be agreed) if asked to do so by the Buyer.**

OR

- **(where enquiry 32.4 applies) confirm whether the most recent previous owner who was entitled to claim allowances entered into a Capital Allowances Act 2001 section 198 election and, if so, in what amount.**

This enquiry is supplementary to enquiries 32.2 and 32.4(b).

If the Seller has pooled expenditure on plant and machinery fixtures, Enquiry 32.2 requires the Seller to answer the supplementary questions in Enquiry 32.9 in respect of the expenditure that the Seller has pooled.

If the Seller is not entitled to pool its expenditure on plant and machinery fixtures, Enquiry 32.4(b) requires the Seller to answer the supplementary questions in Enquiry 32.9 in respect of the most recent previous owner who was entitled to pool its plant and machinery fixtures.

Alternatively, if the Seller has not pooled its expenditure on plant and machinery fixtures but is entitled to do so, Enquiry 32.3 applies (see *CPSE.1 Enquiry 32.3* above).

The information provided in reply is essential in helping the Buyer determine how much of the purchase price for the Property can be apportioned to the plant and machinery fixtures in the Property.

This the amount on which the Buyer will be entitled to claim plant and machinery capital allowances (and is also the amount which the Seller must bring into account as its disposal value for those fixtures). The starting point is that the Buyer can only claim capital allowances on such apportioned part of the purchase price as is "just and reasonable" (see *What is a just and reasonable apportionment?* above) and there are established rules that help the Buyer (or its advisers) work out that apportionment. However, the following rules operate to restrict the amount of that apportionment:

- If a previous owner of the property since 24 July 1996 has pooled qualifying expenditure and so was required to bring into account a disposal value for the fixtures on sale, the apportionment cannot exceed that amount (*section 185, CAA 2001*).
- If the Seller has pooled its qualifying expenditure, the disposal value cannot exceed the amount pooled by the Seller *(section 62 (www.practicallaw.com/5-575-1026), CAA 2001*).

From the Buyer's perspective, its qualifying expenditure will be nil if either of the following apply:

- The pooling requirement (see *Pooling requirement* above) applies, but is not met.
- The fixed value requirement applies (see *Fixed value requirement* below), but is not met.

(*Section 187A(3), CAA 2001.*)

The Seller may have to ask its tax accountant or other adviser for some of the information needed to reply to Enquiry 32.9. Capital allowances for plant and machinery must be formally claimed in a tax return. Under tax self-assessment a taxpayer is obliged to submit a correct and complete tax return and keep appropriate records. Therefore, where Enquiry 32.2 is relevant, in most cases the Seller or the Seller's tax accountant, should be able to provide some details of capital allowances claims made. However, perfect information is unlikely, particularly, if the Property has been owned for many years or the Seller has changed accountant during its period of ownership.

Seller has pooled its expenditure

Where the Seller has pooled qualifying expenditure on plant and machinery fixtures, the fixed value requirement (see *Fixed value requirement* below) will

apply. Unless the fixed value requirement is met within two years of the completion date, the Buyer's qualifying expenditure on those fixtures is deemed to be nil and neither the Buyer nor its successors in title will be able to claim capital allowances in respect of their expenditure on those fixtures. This may reduce the price which the Buyer obtains on a future sale.

However, failure to meet the fixed value requirement will not affect the Seller's obligation to bring into account a disposal value (see *What is a disposal value?* above) for those fixtures. This would be computed on the basis of a just and reasonable apportionment (see *What is a just and reasonable apportionment?* above) of the purchase price (under section 562 of CAA 2001), as limited by section 185 of CAA 2001, and cannot exceed the qualifying expenditure originally pooled by the Seller (*section 62 (www.practicallaw.com/5-575-1026), CAA 2001*).

If the fixed value requirement (see *Fixed value requirement* below) is met, the amount apportioned, which cannot exceed the qualifying expenditure originally pooled by the Seller, will fix both the Seller's disposal value (see *What is a disposal value?* above) and the Buyer's qualifying expenditure on the plant and machinery fixtures.

Fixed value requirement

The fixed value requirement, which must be satisfied within two years of completion of the sale (or grant of the lease), may be satisfied in one of the following ways:

- **Option 1: Tribunal apportionment:** The Buyer applies to the First-tier Tribunal for a determination of the amount of the price of the Property to be apportioned to plant and machinery fixtures on a "just and reasonable apportionment" (see *What is a just and reasonable apportionment?* above) basis under section 562 of CAA 2001, as limited by section 185 of CAA 2001. (The Seller is also entitled to make an application, but is much less likely to want to do so.)

- **Option 2: Joint election:** The Seller and Buyer agree a section 198 of CAA 2001 election (or, on the grant of a lease, a section 199 of CAA 2001 election). This election specifies the Seller's disposal value (see *What is a disposal value?* above). This figure can be anything the parties agree, provided it is not more than the qualifying expenditure originally pooled by the Seller.

When is a section 198 election sensible?

A section 198 (or 199) of CAA 2001 election may be sensible, but usually only if:

- The amount agreed by the parties is "fair" (that is, just and reasonable) and both parties fully understand the financial implications of what they are agreeing to.

- The election is robustly drafted (so cannot be rejected by HMRC).

- It is agreed and submitted to HMRC in time (that is, not later than two years from the completion date of the sale (or grant of the lease). If, within that two year period, an application is made to the First-tier Tribunal for a determination of the just and reasonable apportionment (see *What is a just and reasonable apportionment?* above), the deadline for entering into a section 198 (or 199) election is extended until such time as that application is withdrawn or determined by the tribunal.

The Buyer should consider carefully whether it is in its interests to enter into a section 198 election and, if it does, the amount apportioned to the fixtures.

Section 198 (or 199) of CAA 2001 elections may not work to the Buyer's advantage for two main reasons:

- In the absence of an election the Buyer's claim is calculated by the tribunal on a "just and reasonable apportionment" (see *What is a just and reasonable apportionment*? above) of the price of the Property in accordance with section 562 of CAA 2001 (as limited by section 185 of CAA 2001). Typically, if a property has held its value, or appreciated, this usually would result in the Buyer's qualifying expenditure equating to the Seller's original cost. A buyer who is not properly advised may agree (whether in ignorance or under pressure) an election which shows only a nominal or low amount being apportioned to the plant and machinery fixtures (rather than holding out for a larger and more realistic "just and reasonable" proportion of the purchase price to be attributed to those fixtures). This leaves the Buyer unable to claim valuable capital allowances that would otherwise have automatically been available to it, and gives the Seller the chance to claim more capital allowances than are really justified, despite having sold the Property.

- Elections do not always give the certainty and peace of mind that is envisaged. Experience has

shown that many elections are poorly drafted, or not submitted to HMRC in time. In such circumstances HMRC can, and will, reject them. By the time HMRC has started a compliance check and established that a purported election is flawed, a buyer is likely to find that they are out of time to remedy this and satisfy the fixed value requirement (either by joining in a fresh election or applying to the tribunal for a determination). Therefore, their qualifying expenditure for capital allowances purposes will be nil.

In many cases, the fixed value requirement (see *Fixed value requirement* above) will not apply to certain fixtures. As such, the Buyer must establish a just and reasonable apportionment of the purchase price to those fixtures. This is the case where the Property contains "pre-commencement integral features" (see *CPSE.1 Enquiry 32.3* above). These were first designated, with effect from April 2008, as plant in all circumstances (*section 33A, CAA 2001*). If the Seller incurred its expenditure to build or buy the Property before April 2008, it would not usually have been entitled to claim capital allowances on such items because those assets were not considered to be plant at that time. Therefore, it cannot make an election in respect of such items. However, if such items are bought on or after 1 or 6 April 2008, a Buyer will be entitled to claim capital allowances in respect of those items because statute stipulates that such items always qualify as plant. Here, the only way that the Buyer can establish an appropriate value is by preparing a "just and reasonable apportionment" of the price paid for the Property, which must take account of all of the assets (including the pre-commencement integral features). Therefore, even if an election is agreed, a just and reasonable apportionment may be needed anyway. Such an apportionment may require the advice of a capital allowances valuer.

Seller not pooled but entitled to pool

If the Seller has not pooled its expenditure on plant and machinery fixtures, Enquiry 32.3 asks whether the Seller will do so (see *CPSE.1 Enquiry 32.3* above). If the Seller agrees to do so, the fixed value requirement (see *Fixed value requirement* above) will then apply. As such, if the contract obliges the Seller to pool its expenditure (see *Seller could have pooled expenditure on plant and machinery fixtures but has not done so* above), the Seller and the Buyer may also agree to join in a section 198 election, in which case the Buyer should take into account the considerations referred to in When is a section 198 election sensible?.

Seller not entitled to pool its expenditure

If the Seller is not entitled to pool its expenditure on plant and machinery fixtures, Enquiry 32.4(b) requires this enquiry to be answered in relation to the last previous owner who was entitled to claim allowances. Where the claim was made by a previous owner, it is very unlikely that the Seller will have the necessary details (unless it collected these in when it bought the Property, as is likely to become more common).

Enquiry answers

Enquiry 32.9(a): This requests a meaningful description of each plant and machinery fixture in respect of which qualifying expenditure has been pooled by the Seller (or the last previous owner entitled to claim allowances (see *Seller not entitled to pool its expenditure* above)). Answers such as "all fixtures" or "all fixed plant and machinery" are not acceptable. In practice, it would be burdensome to list each individual fixture separately, so in appropriate circumstances HMRC will normally accept a degree of amalgamation where this does not distort the tax computation. Therefore, the use of sensible elemental descriptions such as "hot water system" or "sanitary ware" will usually suffice.

Enquiry 32.9(b): This requests details of the date or chargeable period (that is, tax year or accounting period) when expenditure was incurred on each of the fixtures described in answer to Enquiry 32.9(a), either by virtue of already being in the premises when the Seller bought the Property, or by being installed by the Seller at a later date. If the Property was purchased second-hand and fixtures were subsequently added during a refurbishment project or on a piecemeal basis, different fixtures may well have different dates of acquisition. Therefore, a date or period is required against each elemental description set out in response to enquiry 32.9(a).

Enquiry 32.9(c): This asks whether the fixture was already in the Property when the Seller bought the Property second-hand, or whether it was installed by the Seller (for example, during refurbishment works). Therefore, for each elemental description set out in response to enquiry 32.9(a), it should be made clear whether that fixture already existed when the Seller bought the Property, or was added to the Property by the Seller.

Enquiry 32.9(d): This asks how much capital expenditure the Seller incurred, and pooled, for each

plant and machinery fixture. Therefore, for each elemental description set out in response to enquiry 32.9(a), the amount of qualifying expenditure originally incurred and pooled by the Seller should be provided. If the Seller is not entitled to pool its expenditure, this should be answered in relation to the last previous owner entitled to claim allowances.

Enquiry 32.9(e) first limb: A simple "yes" or "no" answer is acceptable for this enquiry. The Seller may confirm that the election amount will be the qualifying expenditure originally incurred and pooled by the Seller or may propose another figure (either one that has already been agreed with the Buyer, or one that has to be negotiated).

Enquiry 3.9(e) second limb: All that is necessary to answer this enquiry is to provide a copy of the previous owner's section 198 election.

CPSE.1 ENQUIRY 32.10

Please provide the name and contact details of your capital allowances adviser. Please confirm that we may make contact with him/her in order to obtain information about the matters dealt with in this enquiry 32.

The tax savings arising from capital allowances can be significant and steps can be taken at the time of a transaction to safeguard that benefit. Solicitors/conveyancers may not be fully competent or confident to advise on this.

They may therefore advise their client to commission appropriate assistance from a suitably qualified and experienced specialist capital allowances adviser.

The alternative of excluding tax advice from their services, by an exclusion in the client care letter terms is not a reliable defence against giving the wrong capital allowances advice, or none, because the terms of a retainer can be varied by the parties conduct, and in some circumstances acting beyond those terms may be viewed by the courts as expanding the range of services offered. For example, commenting upon responses to Enquiry 32, drafting capital allowances clauses or warranties, or negotiating section 198 of CAA 2001 elections may negate a taxation advice exclusion set out in the retainer.

While many accountants have a good understanding of capital allowances for plant and machinery fixtures, all advisers differ in expertise and experience and, therefore, not all accountants are comfortable advising on this. However, specialist capital allowances advisers and valuers do exist.

Enquiry answers

This enquiry simply asks for the name and contact details of the person giving capital allowances advice to the Seller.