FORWARD thinking
Spring 2021

Terminology, Entitlement & Fixtures: Traps in Terminology

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In April 2018, we wrote an article for TAXline on the confusion of terminology in relation to capital allowances. The principles remain as valid today as then, though some of the details have changed. What follows is therefore a slightly adapted version of our original article. All statutory references are to CAA 2001.

Capital allowances can be particularly complex (as well as especially valuable) in relation to commercial properties. That complexity is often compounded by the use of imprecise terminology. At the broadest level, the term "capital allowances" includes (for example) research and development allowances (RDAs) and structures and buildings allowances (SBAs), just as it includes plant and machinery allowances (PMAs). So, the use of phrases such as "capital allowances and SBAs" should be avoided.

FIXTURES

The word "fixture" is defined for PMA purposes to denote plant or machinery that is so installed or fixed in or to a building (or other land) as to become in law part of that building or land (s. 173). As such, fixtures (in their capital allowances sense) are a subset of plant and machinery: all fixtures are plant or machinery, but not all plant is a fixture.

Whereas a set of accounts may have headings such as "fixtures and fittings" and "additions to property", we need to reassign the assets in question when it comes to claiming PMAs. Tables and chairs (undoubtedly in the former category in the accounts) are not fixtures, but they are still plant; toilets and fire alarm systems (probably not in "fixtures and fittings" in the accounts) are fixtures for capital allowances purposes (and are therefore, by definition, plant).

INTEGRAL FEATURES

Since 2008, the concept of "integral features" has been a statutory term. By a sleight of statutory wizardry (s. 33A), expenditure on such items as general electrics and lighting and heating systems is treated as if the expenditure were on plant or machinery.

All of the items classified as integral features are in practice affixed to the property and are therefore classed as fixtures for capital allowances purposes (even though, once more, they will not be labelled as such in the accounts). So, the legislation requires us to differentiate between "integral features" (a statutory term) and "other fixtures" (not a statutory term, but the most accurate way to draw the distinction).

CONFUSION OF TERMINOLOGY

There has been a recent tendency in some quarters to use the term "integral features" in circumstances where the user clearly intends to refer to all fixtures. However, these are not synonymous and the distinction really does matter!

The terms "embedded features" and "embedded fixtures" (and, even worse, "embedded capital allowances") have also become quite widespread, perhaps in a bid to simplify the perceived complexity. These expressions are non-statutory and have no official meaning: do they refer to fixtures in general, to integral features or to something else altogether? The use of these ambiguous terms is unnecessary and unhelpful, and often indicates an underlying lack of clarity about what is really being discussed.

Technical Article

Fixtures and buildings – clarifying the terms

When contemplating claims for capital allowances in property, the exact meaning of "fixtures" still causes more confusion than anything else. This arises from the different terminology used for accounting purposes and in the Capital Allowances Act 2001. Statutory references in this article are to that Act.

So where should we look when seeking out the figures needed for the capital allowances computations (and we will focus on plant and machinery allowances only)? On the face of it, the category of land and buildings can simply be ignored, and this appears to be confirmed by s. 21, which states that "expenditure on the provision of plant or machinery does not include expenditure on the provision of a building".

This approach was for decades adopted in practice by too many businesses and their advisers, but it is incorrect and it risks the loss of huge amounts of legitimate tax relief. Take, for example, a new office block constructed at a cost of £2 million. That figure will include such items as electrical and computer wiring, hot and cold water systems, lifts, heating and ventilation, toilets and basins. All of these are part of the cost of the property and will properly be in the accounts under the "land and buildings" category.

Yet all of these items are "fixtures" in their capital allowances sense, and all potentially qualify for plant and machinery allowances. So the distinctions properly used for accounting purposes become problematic when considering capital allowances. But on what statutory basis can allowances be claimed for these items?

CAA 2001 (at s. 173) defines "fixture" to mean "plant or machinery that is so installed or otherwise fixed in or to a building … as to become, in law, part of that building …". So there are two tests if an asset is to be treated as a fixture. First, it must be plant and machinery, and second it must be fixed in such a way as to become legally part of the building (or land).

The requirement that the item must already be plant and machinery seems contradictory, given the s. 21 restriction already mentioned above, whereby expenditure on plant does not include expenditure on the provision of a building. Fortunately, this restriction is "subject to section 23", and s. 23 undoes the statutory restriction for various categories of assets (including integral features) and for various specific assets (including computer wiring).

So taking a wash basin as an example:

- this is plant on general case law principles;
- it is initially prevented from being plant by s. 21 as it is legally part of the building;
- it is rescued from that restriction by s. 23 as it is in the category of "sanitary ware and similar equipment" (List C, item 5); and
- with its status as plant now rescued by s. 23, it is subject to the special fixtures rules, as it is affixed so as to become part of the building.

TESTIMONIAL

I have been working with the Six Forward team for over 7 years and from the outset I was impressed with the responsiveness, reliability and the willingness to go the extra mile in all cases to protect my clients' tax positions… Like others in my peer group I remain impressed by the transparent service, exceptional expertise and can-do attitude to help me to help my clients.

Partner Top 20 Practice

Practical Implications

Taxation query 19,671 – Property disposal

We were recently asked to provide a response to a reader query in Taxation magazine. In essence, there was a holding company and a subsidiary trading company. The freehold of the business property had been transferred from the holding company to a SIPP, following which the subsidiary had spent £100,000 on integral features. The query asked whether a fixtures election under s. 198 would be appropriate in the event of a future sale by the SIPP to a third party such as a property investor. Our reply was as follows, with all statutory references to CAA 2001.

FIRST PRINCIPLES

A fundamental condition for claiming plant and machinery allowances is that a person incurring capital expenditure should own the plant or machinery as a result (s. 11(4)).

Under general property law principles, fixtures in a leased property belong to the landlord rather than to the tenant (Costain Property Investments Ltd v Stokes [1984] BTC 92). If a tenant installs fixtures, this creates a problem: the landlord has not incurred any capital expenditure and the tenant does not own the fixtures, so without special rules neither party can claim.

The fixtures rules (Pt. 2, Ch. 14) resolve this by providing that tenants are in some circumstances to be treated as owning fixtures in the property.

NON-TAXPAYERS AND FIXTURES ELECTIONS

The short answer to the query is that no election under s. 198 for the £100,000 of integral features should, or indeed could, be signed when the freehold is sold by the pension fund ("SIPP") to the property investor ("Investor"). As a non-taxpayer, SIPP cannot claim allowances. As such, it cannot bring any disposal value into account, which is a condition for a fixtures election (s. 198(1)). (As a general principle, charities, pension funds and other non-taxpayers should always sign an election when buying a property, but cannot do so when selling.)

ENTITLEMENT

There is a further factor in this case, however, to preclude any election for the £100,000. SIPP owns the freehold, but the tenant ("Tradingco") occupies the property. As long as that occupation constitutes a lease or a licence to occupy, Tradingco is treated as the owner of the fixtures and can therefore claim allowances for the £100,000 it has incurred (s. 176: person with interest in relevant land having fixture for purposes of qualifying activity).

Nothing that happens at freeholder level can change the fact that Tradingco, rather than SIPP, owns the £100,000 fixtures. So when Investor buys the property, it would normally expect to be able to claim (s. 181: purchaser of land giving consideration for fixture), but in this case Tradingco has a "prior right" (per s. 181(2)). So Investor cannot claim for those fixtures (a point its advisers will need to spot before it buys!).

OTHER FIXTURES

That may not quite be the end of the story, however. Tradingco is treated as owning the £100,000 fixtures, but SIPP may own other integral features or general fixtures. For example, is there general lighting that remains in place from before? The question of whether a claim is possible for such other expenditure will depend on various factors. If all the boxes are ticked, a claim by Investor will be possible, but the mechanics will be different as SIPP can still not sign an election on sale.

As with all fixtures claims, the essential first step is to see who, if anyone, is entitled to claim.

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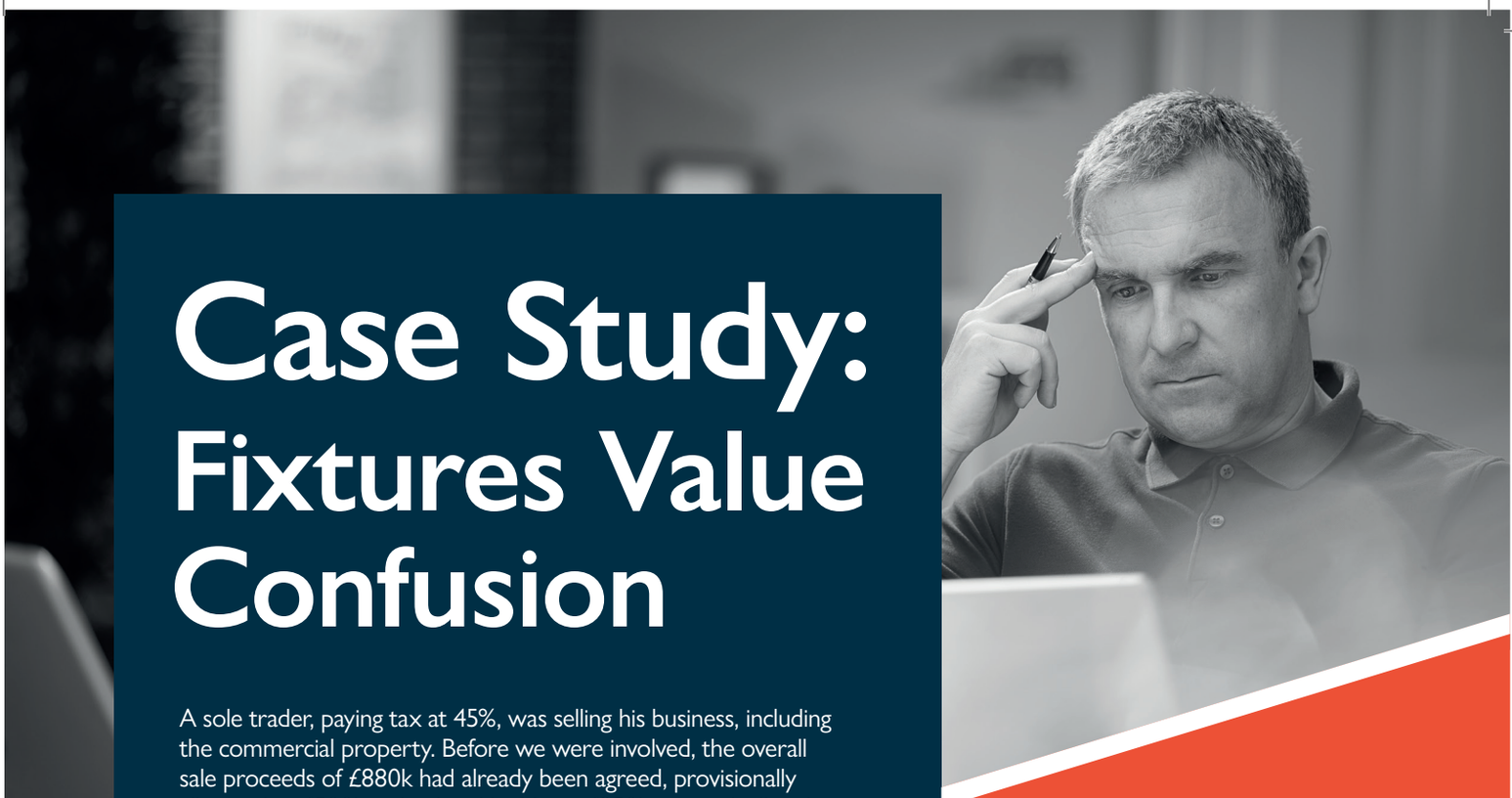

Case Study: Fixtures Value Confusion

A sole trader, paying tax at 45%, was selling his business, including the commercial property. Before we were involved, the overall sale proceeds of £880k had already been agreed, provisionally allocated as £500k to land and buildings, £250k to goodwill and £130k to fixtures and fittings.

The vendor had previously identified qualifying expenditure of some £150k on fixtures in the property. These (together with any other plant in the pools) had been written down to a balance of around £80k. The vendor had already been advised that he would be hit with a balancing charge of £50k – not an ideal outcome for the client, but we were instructed that this was a tax price he was willing to pay for the deal to go through.

Unfortunately, the client's advisers had assumed that £130k would be the total capital allowances disposal value. When it came to discussing a fixtures election (under s. 198), however, the buyer's advisers were looking for some figure allocated to fixtures, over and above the £130k allocated to "fixtures and fittings". In other words, this was a classic example of misunderstanding when using the word "fixtures" – see our article on the front page.

It was essential for our client to sign a fixtures election, to prevent a large balancing charge for the vendor (see s. 187B(6)). However, the £130k allocated to moveable items was (on the facts) probably excessive, and any figures not covered by an election are open to challenge by HMRC if they do not constitute a "just and reasonable apportionment" (s. 562). A compromise was to allocate a smaller figure (£40k) to those items, and to sign an election with £90k allocated to fixtures, retaining an overall capital allowances disposal proceeds figure of £130k, with minimal risk of HMRC challenge.

The reduction from £130k to £40k allocated to fixtures and fittings would have to be matched by an increase in the amount allocated to either goodwill or to land and buildings. Our client would have some increased tax liability as a result, but this was still a much better result than having a higher figure allocated to plant and machinery.

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MYTH VS FACT

MYTH FIXTURES IN OLD BUILDINGS MUST BE OF NEGLIGIBLE VALUE

If a property is being bought and sold, or if it has been owned for many years with little in the way of capital allowances claims, it may be thought that the value of any fixtures is likely to be very low. This is not how it works in reality.

If we are looking at a building bought many years ago, the historic cost determines the value of the claim – as long as the fixtures are still in the property.

Where a used building is being bought, the calculation of the value of the fixtures is based on their replacement value, rather than on their value if stripped out and sold separately. This approach, which attributes a much higher figure to fixtures, has approval of both HMRC and the tax Tribunals. In most cases, a fixtures election will be needed.

MYTH THE ACCOUNTS CORRECTLY SHOW £100,000 ADDITIONS FOR FIXTURES AND FITTINGS, AND I HAVE CLAIMED ALLOWANCES FOR THOSE, SO NO MORE ALLOWANCES ARE DUE

This happens often in practice, but is neglecting a huge part of the potential claim.

Suppose that a new office building is constructed for £1.2m, and that a further £100,000 is spent on fitting it out. The £1.2m is shown as additions to property and the £100,000 as fixtures and fittings. Capital allowances are claimed on the latter figure only.

The £1.2m on the property includes large amounts of fixtures (in their capital allowances sense) on which allowances are due – all the electrical work, heating, hot and cold water systems, lifts, fitted furniture, toilets and so on. In reality, the £100,000 represents a small fraction of the overall potential claim.

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SIG (Special Interest Group)

We're delighted to be able to welcome you to the Capital Allowances SIG.

By joining this group, you'll receive the tools you need to deal with common and complex capital allowances situations to support your day-to-day client work. The SIG won't just inform you about the latest changes, its contributors will take the time to explain the implications and, most importantly, what actions you need to take for your clients. Whether you want to update your knowledge or gain a deeper understanding, the tailored content in this group can help you.

We know that the sheer volume of and constant changes to tax legislation in the UK can be overwhelming – new Finance Acts each year, long case law reports and sporadic updates to HMRC guidance. This SIG is an essential resource if you are looking to stay up to date with the latest technical and regulatory changes and receive practical advice.

The invitation to join SIG can be found here:
www.linkedin.com/groups/13844030

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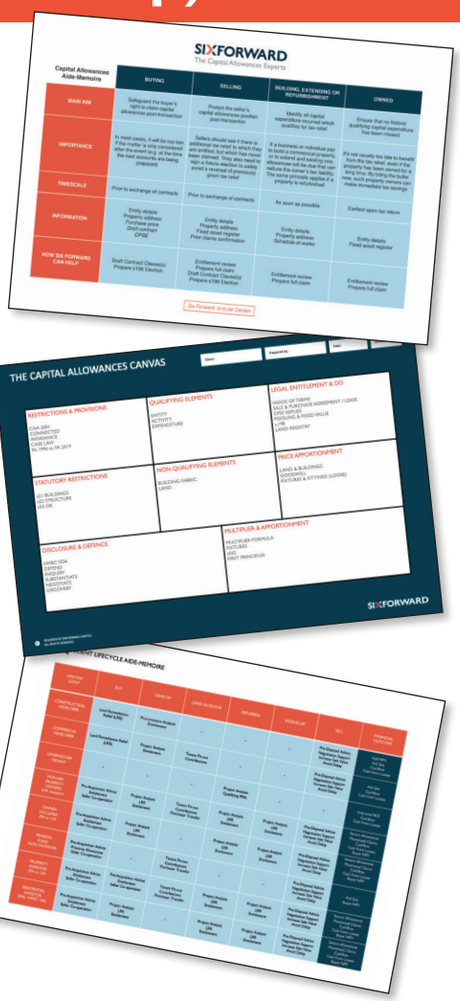

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