

When is a building not a building?

The Upper Tribunal decision in the *Urenco* case reminds us once more that certain core definitions in relation to plant and machinery allowances cannot be taken for granted.

The question of whether, or to what extent, plant and machinery allowances (PMAs) can be claimed for buildings remains one of the most hotly disputed issues in the capital allowances world. Most years bring one or two important case law decisions (often involving high amounts of expenditure) that touch on this topic in one way or another.

NO PLANT OR MACHINERY ALLOWANCES FOR BUILDINGS?

The legal starting point is pretty clear: "expenditure on the provision of plant or machinery does not include expenditure on the provision of a building". That already seems restrictive, but in fact the legislation goes on to declare that the word "building" includes:

- any asset incorporated in a building; as well as
- a whole list of assets if they are "in or connected with" the building. This list includes, for example, walls, floors, windows, stairs, mains services, sewerage systems, lift shafts and fire safety systems.

BUT FIXTURES DO QUALIFY FOR PMAs

If that were the end of the matter, almost nothing affixed to a property would qualify for PMAs. Fortunately, however, there are many exceptions, and these ensure that PMAs can be properly claimed for a wide range of fixtures, from ordinary electrical wiring to refrigeration systems, sanitary ware, heating systems, display equipment, and much more.

So far, so good. What is becoming clearer, however, is that certain words may need a more subtle interpretation than that being used by HMRC.



WORDS DO NOT ALWAYS HAVE THEIR "OBVIOUS" MEANING

The tax tribunals are starting to challenge assumptions about the meaning of key words in the capital allowances legislation. So far, these challenges have tended to favour the taxpayer rather than HMRC. As the challenges are mostly in the Upper Tribunal (UT) or above, they are highly significant, as the principles must be applied in all lower courts, including the First-tier Tribunal (FTT) to which tax appeals are initially made.

In the *SSE Generation* case, for example, the Court of Appeal challenged HMRC's interpretation of "tunnel" and of "aqueduct". The case involved some very nuanced interpretations but, in summary, various items that HMRC wished to allocate to the general description of "tunnel" (so as to deny allowances on the basis that these were prohibited structures) were held not to be tunnels for those purposes.

NARROWER MEANING OF BUILDING

The UT in *Urenco* spent some time analysing the meaning of "building" in the context of the plant and machinery restrictions. The tribunal questioned the whole assumption that the "ordinary meaning" (of a word such as "building") is a precise concept, referring back to the *SSE Generation* decision that a more nuanced approach was required to interpret some common words.

In considering the restrictive effect of the legislation in relation to "building", the tribunal in *Urenco* noted that many words have a number of ordinary or everyday meanings, and that the widest such meaning is not necessarily the correct one in the given statutory context. Indeed, the tribunal stated that:

“An analysis which takes as its starting point that 'building' bears its ordinary everyday usage has the superficial attraction of simplicity but may lead to a flawed conclusion.

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The UT in *Urenco* took the view that there was a potential "spectrum of everyday meanings" of the word "building". At one extreme, a building might be anything with four walls and a roof, and/or anything that looks like a building, regardless of its function or purpose. At the other end of the spectrum, something would only be described as a building if its predominant function was one of the central functions of a building, such as shelter.

The FTT in *Urenco* had been right to take account of both the characteristics and the function of an asset when deciding whether it is a building, but the FTT had got the balance wrong (for example in relation to a condenser facility):

“The authorities make clear that the function actually performed by an asset in the trade carries very considerable weight in determining whether it is plant. We consider that section 21 [the legislation denying allowances for buildings] does not have the purpose or effect that in then determining whether an asset is disqualified from being plant because it is a building an approach should be adopted in which appearance or physical characteristics are predominant and the actual and predominant functions of the asset are subsidiary.

That is quite a complex sentence but, in short, an asset that looks like a building (and is perhaps even described as a building) *but that functions primarily as something else* may not be caught by the restrictions of section 21 at all.

There are plenty of other potential complications (including negotiating section 22, which restricts PMAs for many structures), but this nuance could be very significant in some cases.

The Upper Tribunal decision is reported as *Urenco Chemplants Ltd & Anor v HMRC* [2022] UKUT 22 (TCC). Other aspects of the decision are analysed in detail in the 2022-23 edition of *Capital Allowances*, written by Six Forward authors and available from Claritax Books.

Annual investment allowances – all change (yet again)

Annual investment allowances (AIAs) offer accelerated tax relief for most expenditure on plant and machinery, and will be familiar to nearly all businesses and their professional tax advisers. AIAs can simplify the tax computation, giving full relief in one go, rather than spread out across future years. AIAs can also offer significant cashflow advantages.

WHAT IS THE LIMIT ON CLAIMING AIAs?

The amount of expenditure that can attract AIAs in any given year is capped. Although the figures are high enough to cover most businesses without restriction, the cap can affect three categories of business in particular:

- larger businesses (as they spend more);
- any business that incurs exceptional levels of expenditure in a given year (as such a business may find that its expenditure breaches the cap in that year); and
- businesses that are part of a group or that otherwise have connected parties (as they will have to share a single AIA amount between them).

The AIA was introduced in 2008, and the annual cap has fluctuated frequently over the first decade and a half of its existence. Although the current figure is £1 million, this is technically a temporary increase only, and the default figure remains at £200,000.

DOES THE REDUCTION IN AIAs HAVE RETROSPECTIVE EFFECT?

As things stand, the temporary figure of £1 million is set to revert permanently to £200,000 from 1 April next year (2023). This is misleading, however, as the change can in fact have retrospective effect and can reduce the available AIA for expenditure incurred any time from April 2022 onwards.

HOW DO YOU CALCULATE THE MAXIMUM AIA THAT IS DUE?

This can be complicated, so it is best to remove some of the variables from the calculation. Let's assume, therefore, that we are dealing with a standalone company that does not have any associated companies. And let us suppose that the company in question draws its accounts up to 30 June each year.

When the headline rate falls from 1 April 2023, it is necessary to make two separate calculations for the accounting period that straddles that date, so for expenditure incurred during the year to 30 June 2023. Each of these calculations can potentially impose a cap on the amount of AIA that the company can claim.

HOW IS THE FIRST CAP CALCULATED?

First, there is a cap on the overall amount of expenditure in the year that can qualify for AIAs, irrespective of when the expenditure is incurred.

This is why the rules operate retrospectively: even if the company spends the money early in the accounting period, before the reduction that applies from 1 April 2023, its maximum AIA is capped at a lower figure than £1 million.

EXAMPLE 1

Company A runs a number of care homes in the Midlands. It is not part of a group of companies and does not have other associated companies. Its accounts are drawn up to 30 June.

The directors are aware that the amount of AIA is set to reduce from 1 April 2023 and this is one factor in the company's decision to carry out major renovation work to some of its properties in the period from 1 September 2022 to 31 January 2023. This includes qualifying expenditure on plant and machinery (mostly property fixtures) amounting to £1.2 million.

The accounting period (year ended 30 June 2023) contains nine months before the reduction comes in (where the annual AIA cap is £1 million), and three after the change (where it is £200,000).

The maximum AIA is therefore calculated – as follows:

$$1,000,000 \times \frac{9}{12} = \text{£}750,000; \text{ plus}$$

$$200,000 \times \frac{3}{12} = \text{£}50,000.$$

So the maximum AIA the company can claim is £800,000, even though the expenditure was all incurred before the headline rate of AIAs was reduced.

HOW IS THE SECOND CAP CALCULATED?

An additional cap applies to expenditure incurred from 1 April 2023 to the end of the chargeable period. This is a separate calculation that can be very restrictive, but that does not have retrospective effect on expenditure incurred before 1 April 2023.

The calculation is made according to the length of the period from 1 April, and by applying this to the new (lower) AIA cap.

EXAMPLE 2

Company B operates a manufacturing business. Once more, the company draws accounts up to 30 June.

The company incurs qualifying expenditure on plant and machinery of £650,000 in its year to 30 June 2023. Of this figure, just £60,000 is incurred before the start of April, with the balance of £590,000 all incurred in the last three months of its accounting period.

As with the first example, the maximum AIA the company can claim for the whole period is £800,000, so that does not present a problem.

In this case, however, the second cap will have an important effect. As there are just three months in the period from 1 April to 30 June 2023, and as the annual AIA cap is then set at £200,000, the cap for expenditure incurred in this period is calculated as just £50,000 (i.e. £200,000 x $\frac{3}{12}$).

The company can therefore claim AIAs of £60,000 for expenditure before 1 April, plus the maximum of £50,000 for expenditure incurred in the last three months of the accounting period. So the maximum AIA it can claim is just £110,000.

This is an unfortunate outcome. If the company had instead incurred the expenditure before 1 April, it could have claimed AIAs on the whole £650,000. If it had waited until after 30 June 2023, it could have claimed £200,000 (though the tax relief would then be deferred for a year).

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What happens to the excess?

It must be remembered that AIAs are not a different type of capital allowance but are merely one important way in which tax relief is given for qualifying expenditure on plant and machinery. If AIAs are not available for whatever reason, or are capped as in the above examples, relief will still be given, but by way of writing-down allowances (WDAs). The amount of relief given will eventually be the same, but some of the tax relief will be delayed.

AIAs and WDAs can in fact be given in the same set of capital allowances computations.

SIMPLE EXAMPLE

A company spends £250,000 in a year for which its AIA limit is just £200,000. It can claim the AIAs of £200,000 but can also claim WDAs on the excess of £50,000 in the same period. If the WDAs are at 18%, the total capital allowances claim for the year will be £209,000 (£200,000 plus 18% of £50,000).

Tax relief on the remaining £41,000 will be given over future years, by way of writing-down allowances.

OTHER IMPORTANT POINTS

This article illustrates the complications that arise when the AIA cap is reduced. It is important to remember that many other rules and restrictions apply, so professional advice should always be sought. Here are some of the key points that arise most often in practice:

- AIAs are only given for qualifying expenditure (as defined) on plant or machinery (again, as defined), and this is a complex area of law in itself.
- AIAs are not available for certain entities, for example for trusts or for partnerships that include either a trust or a company.
- AIAs are not given for cars, even those with low or zero emissions.
- AIAs are available, however, for integral features (another defined term) so are very important when a business is undertaking a construction project.

- AIAs are only available for expenditure incurred in the year in question. If a late claim is being made, for example in relation to a property acquired some years ago, no AIAs can be claimed, so relief will be given only by way of writing-down allowances.
- Companies in a group, and various other associated businesses, have to share a single AIA limit.

FINAL CONSIDERATIONS

This article considers the issues that will arise if, as expected, the AIA cap reduces from £1 million to £200,000 from 1 April 2023.

It now seems likely that there will indeed be a reduction in the AIA limit from that date. It is perhaps less certain, however, that the new cap will be set at £200,000, even though (for now) that remains the default level for AIAs. At the time of the Chancellor's Spring Statement in March 2022, the government published a report listing "illustrations of the types of change that the government could make" at some future point. One such change was a permanent increase in the level of AIA to £500,000. Setting the level at £500,000 for the long term seems quite a likely outcome, though it is no more than informed speculation at this stage.

The text and examples in this article are adapted from *Capital Allowances 2022-23*, written by Ray Chidell and Jake Iles of Six Forward Capital Allowances, and published by Claritax Books.

MYTH VS FACT

MYTH STRUCTURES AND BUILDINGS ALLOWANCES OFFER A SIMPLER ALTERNATIVE TO FIXTURES CLAIMS

Structures and buildings allowances (SBAs) for expenditure incurred from late 2018 give tax relief on the cost of most non-residential buildings and structures on a straight-line basis over many years. Some people have suggested that claiming SBAs on everything may be a simpler option than identifying fixtures for a plant and machinery claim. This is flawed for two reasons. First, SBAs are much less advantageous for a whole host of reasons, including in particular slower tax relief, a lack of control at the point of sale, and a high potential cost in terms of increased tax on any capital gain. More fundamentally, however, the SBA rules explicitly state that the newer allowances cannot be given for fixtures in the property.

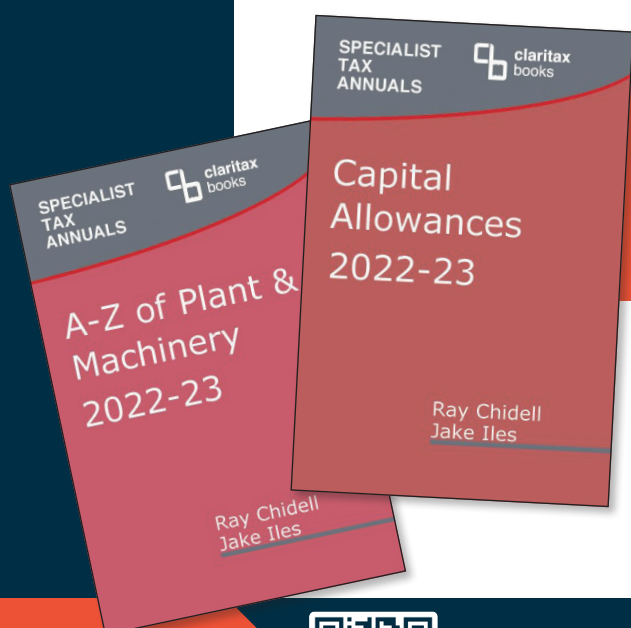


Structures and Buildings Allowances SBAs

SBAs are given for the construction costs of non-residential properties and structures.

The key features of the SBAs regime are as follows:

1. Allowances are given at a flat rate of 3% (formerly 2%) per year, but at a higher rate for freeport tax sites.	7. The first use of the building, after the qualifying expenditure has been incurred, must be non-residential.
2. Allowances are available for commercial buildings and structures, but not for residential property. No allowances are given for land costs.	8. There are no first-year allowances, annual investment allowances or balancing adjustments. Strictly speaking, there are no writing-down allowances either – just “allowances”.
3. The right to claim allowances until they are exhausted passes to the new owner when a building is sold. The new owner is required to obtain appropriate documentation to underpin the right to claim.	9. The person claiming the allowances must have the relevant interest in the building. Special rules apply for certain leases of 35 years or more.
4. Allowances are given for new construction costs incurred from 29 October 2018, as long as no contract for the construction works was entered into before that date. Allowances are not available for a purchase after that date where the construction expenditure was incurred before that date.	10. Allowances are not available under the SBA regime for property fixtures (including both integral features and other fixtures). The cost of fixtures must therefore be isolated and claimed separately under the regime for plant and machinery allowances.
5. Allowances are also given for capital renovation and conversion costs.	11. Allowances cease if the building is brought into residential use.
6. Allowances can only be given once the building or structure has been brought into qualifying use. Thereafter, allowances may continue to be given during periods of disuse. However, no further allowances are given once the building is entirely demolished.	12. Various anti-avoidance measures apply, notably in relation to the start date of 29 October 2018, to costs in excess of market value, and to other avoidance arrangements.



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