The changes to the capital allowances regime will affect all businesses acquiring or selling property and plant and machinery (including fixtures), with the changes impacting business across various sectors – are you ready?

Finance Act 2011 introduced changes to the capital allowances regime which take effect from 1 April 2012 (for businesses within the charge to corporation tax) or 6 April 2012 (for businesses within the charge to income tax). The changes reduce the rate of writing down allowances on plant and machinery in the main pool from 20% to 18% and the special rate pool (including integral features and long life assets) from 10% to 8% per annum on a reducing balance basis. In addition, the anticipated reduction to the annual investment allowance from £100,000 to £25,000 per annum also comes into effect from these dates.

The further changes now proposed are the result of several consultations published on 31 May 2011. The Summaries of Responses to these consultations, along with draft legislation, were published on 6 December 2011, and responses to the technical detail of the legislation are sought by 10 February 2012. Finance Bill 2012, including any new or revised legislation, will be published on 29 March 2012.

This alert provides an overview of the reforms and their impact.

**Mandatory pooling for fixtures**

The proposed legislation will make the availability of capital allowances for fixtures dependent on the pooling of expenditure by the vendor prior to a disposal. In addition, the seller and the purchaser will be required to either agree a value for fixtures or to instigate formal proceedings to agree the value within two years of a transfer.

New legislation will apply from 1 April 2012 for corporation tax or 6 April 2012 for income tax, with transitional rules until (1 or 6) April 2014.

The original proposal to make pooling mandatory after acquisition of the fixture has been amended. To enable the new owner to make a capital allowances claim it will become mandatory for the vendor to pool expenditure on fixtures at any time prior to their disposal or transfer.

The proposal to introduce a Record of Agreement between two parties on the disposal of fixtures has been dropped. Instead, taxpayers must either use existing procedures by...
The legislation will continue to operate as it does now for capital expenditure projects.

It is encouraging that the views of businesses and advisors have been considered by HMRC and the draft legislation developed accordingly. These reforms for acquired plant and machinery fixtures should provide greater certainty to purchasers (and vendors), although care must still be taken to ensure a valid claim can be made.

The Government estimates that, as a result of the changes, taxation receipts will increase by approximately £30mn per annum. Taxpayers who acquire property should ensure that they establish full tax history and prior capital allowances claim position of the property to support their claim. Businesses may wish to consider appointing a specialist capital allowances advisor to establish the full tax history of the acquired property and to obtain documentary evidence to support their claim.

Anti-avoidance rules for plant and machinery

Amended anti-avoidance provisions have now been published to strengthen the counter abuse of the rules for plant and machinery allowances.

Four key changes have been proposed to legislation that currently applies to restrict capital allowances that may be claimed in respect of certain ‘relevant transactions’. These apply from 1 April 2012 for corporation tax and 6 April 2012 for income tax:

- The ‘transactions to obtain allowances’ provisions in section 215 CAA 2001 will include a new ‘purpose’ test, rather than the existing sole or main benefit test.
- Where the new section 215 applies, the advantage the transaction sought to obtain will be cancelled out.
- ‘Relevant transaction’ explicitly includes novations and other transfers, due to a clarification of the term ‘assigns’.
- The exemption providing for manufacturers acting in the ordinary course of their business is repealed from 1 April 2012 where obtaining a tax advantage is one of the main purposes of their participation in the arrangements.

The legislation will continue to operate as it does now for transactions between connected persons and sale and leaseback transactions, as long as there is no avoidance purpose. Similarly, the anti-avoidance rules will continue to deny first-year allowances and annual investment allowances where it appears that the purpose of a transaction is to obtain an allowance.

Overall, the changes appear to move towards a more subjective purpose consideration and a broadening application of the specific anti-avoidance sections in Part 2 CAA 2001. Taxpayers should consider these provisions very carefully before undertaking any connected party or sale and leaseback transactions involving plant and machinery or any planning where it could be held that they have sought to obtain a tax advantage.

Feed-in tariffs and the renewable heat incentive

Legislation is to be introduced with effect from April 2012 restricting the nature of energy saving plant and machinery that attracts 100% Enhanced Capital Allowances (ECAs).

Plant and machinery generating electricity or heat culminating in the taxpayer claiming a feed-in tariff (FIT) or renewable heat incentive (RHI), will not be eligible for 100% ECAs. Expenditure that would have been eligible for ECAs may attract allowances within the main plant and machinery pool of 18% per annum on a reducing balance basis. These changes will not affect expenditure incurred on combined heat and power (CHP) plant until April 2014.

Capital expenditure incurred on the provision of solar panels will no longer attract either 100% first year allowances (FYA) or 18% writing down allowances (WDA), and instead will be restricted to claiming WDA within the special rate pool of 8% per annum on a reducing balance basis.

The overall changes made to the capital allowances regime affecting energy saving plant and machinery attracting the FIT or RHI are not as harsh as had been envisaged. Whilst investors in solar PV technologies will be further disappointed following this reduction in allowances coupled with the reduction in the level of FIT available, investors in CHP will be encouraged by their delayed inclusion in these rules.

The Government has also reduced the FIT incentives for solar installations. This has been challenged at the High Court which ruled that the Government had breached the rules governing the consultation exercise. Proposed cuts to the FIT would impact installations completed before the end of the consultation period. This matter is subject to appeal.

Taxpayers who proposed to undertake solar PV projects should consider the impact of these reforms on their financial models.

Enterprise Zones: first-year allowances for designated areas

One hundred percent temporary FYAs will be available for companies investing in new and unused plant and machinery for use in designated ‘assisted areas’ within certain new Enterprise Zones for a five year period commencing from April 2012 until 31 March 2017.

Existing FYA restrictions will apply along with further exclusions including FYAs not being available for companies in ‘difficulty’ or subject to an outstanding recovery order, and for certain industries such as fisheries, mining, coal, steel and shipbuilding or...
any in the production of agriculture products and the management of waste undertakings.

It has been announced that, in England, the FYA will only be available to companies, in certain designated areas, within the following zones:

- Black Country
- Humber
- Liverpool
- North Eastern
- Sheffield
- Tees Valley

The maximum level of qualifying expenditure that can attract FYAs is €125mn for any investment project.

The Welsh Government has announced that it will be creating five new enterprise zones each with its own targeted selective sector. The five preferred locations for the zones are:

- Cardiff Central Business District – financial services sector
- Anglesey – energy sector
- Deeside – advanced manufacturing sector
- St Athan – aerospace sector
- Ebbw Vale – automotive sector

The Scottish Government has also announced that it will be creating four enterprise 'areas' which will focus on the manufacturing, life sciences and low carbon renewable energy sectors. The enterprise 'areas' have targeted sectors and 14 selected sites have been allocated to the zones. The enterprise areas are:

- Life science – Irvine, Moray, Highlands, Edinburgh and Midlothian
- Low carbon/renewables 1 – East (Ports in Dundee and Leith)
- Low carbon/renewables 2 – North (Hudson and Lyness in Orkney, Arnish in the Western Isles and Nigg and Scrabster in the Highlands)
- Manufacturing – Creative Clyde Waterfront area of Glasgow and Prestwick International Aerospace

No details have been provided on the incentives that will be available for investors and occupiers in both Wales and Scotland and it remains to be seen as to whether the zones and 'areas' will be eligible for the 100% FYA.

Business Premises Renovation Allowances

The announcement in Budget 2011 that Business Premises Renovation Allowances (BPRA) are to be extended for a further five years to 2017 has been welcomed by property owners, investors and occupiers.

BPRA will continue to provide a 100% initial allowance for expenditure on converting or renovating disused business premises in designated ‘assisted areas’. To ensure BPRA continues to comply with State Aid rules, taxpayers must also satisfy the following additional provisions:

- Qualifying BPRA expenditure will be capped at €20mn per project.
- Businesses that are in difficulty, or are subject to an outstanding recovery order from making BPRA claims, are excluded from this relief.
- BPRA will only be available for property that is in an ‘assisted area’. The Government will revise the coverage of ‘assisted areas’ with effect from 1 January 2014 and those no longer designated will cease to qualify for BPRA.

Taxpayers should consider their entitlement to claim this relief and, if claiming this relief, may be required to identify and analyse separately any non-eligible BPRA expenditure.

Land remediation relief

The proposal to repeal contaminated land relief has been withdrawn. Companies will continue to qualify for a deduction of 100%; plus an additional deduction of 50% for qualifying expenditure incurred by companies in cleaning up land acquired in a contaminated state. In addition, a company that has a qualifying land remediation loss for an accounting period still has the option to make a claim to surrender the loss, or part of the loss, in return for a 16% land remediation tax credit.

The Government’s decision not to abolish land remediation relief comes following its consideration of the consultation responses from companies and representative bodies, who argued that removing the relief would affect the regeneration of uneconomic brown-field sites making some proposed schemes financially unviable. The Government has decided that the removal of this relief, in conjunction with the already agreed removal of the landfill tax exemption, would risk undermining its plans to support the housing and construction sectors through planning reforms and the release of large areas of publicly owned land for development.

The decision not to repeal land remediation relief has been welcomed by companies and property developers who are already experiencing financial pressures in the construction and housing sectors, and which would have been exacerbated further had this reform proceeded. Taxpayers should review their expenditure to ensure that this relief is obtained where available.
Abolition of capital allowances

It has been confirmed that the capital allowances reliefs for safety at sports grounds are to be repealed. The Government reiterated its position that the stock of existing sports grounds has now been brought up to the safety standards appropriate for the size and use of the grounds. Safety at sports grounds relief will be repealed in Finance Bill 2012 with effect from 1 April 2013 (for corporation tax) and 6 April 2013 (for income and inheritance taxes).

Similarly, flat conversion allowances, which provide a 100% allowance for the conversion or renovation of empty or underused space above shops and other commercial premises to residential use, are also to be repealed. The Government decided that no new compelling evidence had been provided to retain this relief and this will be repealed in the same manner as safety at sports grounds.

Short-life assets

Businesses incurring expenditure on plant and machinery assets are now able to make a short-life asset (SLA) election in respect of that item if they expect to sell or scrap it within an eight year cut-off period. This reform to extend the cut-off point for a SLA from four to eight years, came into effect for SLAs from April 2011 and the previous exceptions continue.

This reform has extended the SLA regime to businesses investing in assets with longer useful lives and has benefited those who invest sums in plant and machinery in excess of the annual investment allowance. Businesses in the retail, hotel and leisure sectors that have refurbishment programmes every four to eight years are now benefitting from this reform.

Next steps

Ernst & Young has been actively involved with both the Government and taxpayers throughout the consultation process and our dedicated specialist capital allowances team will be pleased to discuss any aspect of the changes. Likewise, should you wish to raise any concerns or have comments on the proposed legislation we will be happy to consider these with you.

Why Ernst & Young

Ernst & Young provides advice to investors and occupiers of commercial properties. Whether it is a second hand acquisition; a new development; undertaking a fit-out; refurbishment or alterations, our specialist advice can add real value to your business.

Our dedicated capital allowances team combines chartered surveyors and qualified tax professionals to provide a comprehensive service. Additionally, being part of our much broader real estate tax team means that we can pull in other specialist tax advisors to address wider property issues including stamp duty, VAT and corporate tax.

We have an outstanding track record in achieving exceptional value for businesses, whichever sector they operate in.

For further details on this or any other capital allowances matters please do not hesitate to contact the following members of our team or your usual Ernst & Young contact:

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