

Capital Allowances on Fitting Out Works

When a tenant spends money on fitting out a property there are a number of issues that need to be looked at in order to establish the tax relief available through capital allowances;

Incentives

Often a tenant will be offered some form of inducement to take the lease. When agreeing the deal it is essential that the tax implications are taken into account before anything is signed.

Capital contributions - If a tenant is receiving a capital contribution from the landlord or a grant from an external source then this subsidy has to be taken account of in computing the capital allowances available. In the case of capital contributions it is vital that the terms of the agreement are investigated as the Landlord may be entitled to claim capital allowances. Some agreements set out specifically what the contribution is for and others are more general. This will significantly affect what the tenant can claim. See CAA 2001 sections 537 & 538.

Usually a capital contribution will be a taxable receipt, however, if the tenant receives a contribution towards plant and machinery the capital receipt is not taxable. This means there is no loss of benefit by allowing the landlord to have the capital allowances.

Rent free periods - a rent free period is not a subsidy for capital allowances purposes and so will not affect a tenant's claim. It should be noted, however, that the tenant will still get a tax deduction for "notional rent" paid during the rent free period even though no rent is being paid.

Plant and machinery

Capital allowances should be considered during the design stage of any works. This is especially important where the mechanical and electrical works are concerned as some items could qualify for the 100% First Year Allowance – see below. Other items of plant and machinery can be identified by reference to CAA 2001, Section 23, list C which sets out the main qualifying categories. The rate at which these items can be claimed will depend on its nature, as follows;

- Expenditure on energy saving or water saving technologies that meet the specific Enhanced Capital Allowances rules – 100% first year allowance
- General plant and machinery items – Currently 20% on a reducing balance basis but will be reduced to 18% from April 2012.
- Integral features and Long Life Assets – Currently 10% on a reducing balance basis but will be reduced to 8% from April 2012.

Despite the list, there are still some "grey" items. For example, de-mountable partitions. HMRC will only allow these if there is an intention to move them as part of the trade. Most businesses install demountable partitions to enable them to alter offices layouts to suit future business needs but don't record this fact. Planning ahead is, therefore, essential so that documentary evidence such as instructions to the design team can be given to HMRC in support of the claim.

There is, another difference with fitting out schemes in that items of a structural nature that would not usually be allowable, can be claimed if the works are "**incidental**" to the installation of the plant or machinery- see CAA 2001, section 25.

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Typical items that could be classified as incidental works include;

- Installing a new lift shaft
- Demolition and rebuilding of walls to gain access for large items of plant or machinery
- Construction of steel or concrete platforms to support plant items
- Strengthening of existing floors to take increased loadings due to plant installations
- Drainage installations where new kitchens or toilets have been installed

The main problem with claiming “incidental works” is one of identification. Firstly it is necessary to have a close understanding of the project works so that any potential items can be investigated. Secondly, once the items have been established the costs of the works have to be calculated. Often these will be in the substructure or superstructure elements or could just be within lump sum costs. Obtaining copies of the construction drawings, before and after photographs as well as close liaison with the building contractor are all key to preparing a detailed claim for incidental works. This can be time consuming but section 25 works can often add up to more than 50% of the overall claim so the investment can pay dividends.

One further point on incidental works; they should be allocated to the relevant pool based on what the works relate to. For example a new lift shaft would be in the Special rate pool for integral features.

Other issues

It should be remembered that for all expenditure after 1 April 2008 (Corporation tax) and 5 April 2008 (Income tax) the first £50,000 of a business's expenditure on plant and machinery is given as the Annual Investment Allowance and can be claimed at 100%. For expenditure in years ending 2011 and 2012 this AIA has been increased to £100,000. After 5th April 2012 it is being reduced to £25,000.

Business Premises Renovation Allowances (BPRA's) - This initiative is designed to bring back into use derelict or unused properties within specified disadvantaged areas. A disadvantaged area is one set out in the Assisted Areas Order 2007,107. There is a useful post code checker which can be found at;

<http://www.dtistats.net/regional-aa/aa2007.asp>

Qualifying expenditure is that involved in converting, renovating or repairing a commercial building in a disadvantaged area that has been unused for at least a year. The last use cannot have been as a dwelling. Extending a building or developing land next to a qualifying building does not qualify for BPRA's.

There is an initial allowance of 100% of the qualifying expenditure. If the initial allowance is not claimed in full, then a writing down allowance of 25% on a straight line basis is given.

If the property is sold or a long lease granted within seven years of the first use of the building after conversion or renovation then there is a balancing adjustment which could result in a balancing adjustment or allowance.

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