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Commercial property and capital allowances

Since April 2012, vendors who have claimed capital allowances have been required to pool qualifying expenditure and enter into a CAA2001 s.198 election in order to transfer the allowances to the purchaser. For any transaction from April 2014, even if the vendor themselves had not claimed capital allowances, if they were in a position qualifying them to make a claim for capital allowances, they then have a requirement to pool these allowances in order to enter into a CAA2001 s.198 election with the purchaser.

Before the introduction of the 'new capital allowances regime' it was common practice for the purchaser to keep quiet about capital allowances during the purchase stage since the onus fell on the vendor to ensure a CAA2001 s.198 election was entered into, given this was the only real mechanism available for the vendor to retain the tax benefit of claiming capital allowances. However, since April 2012 there has been a shift in the importance of who should consider capital allowances and as such it falls on both parties, but mainly the purchaser.

If the vendor has claimed capital allowances and no one addresses the transfer of these allowances at the time of sale, then the allowances will be retained by the vendor and nothing will pass on to the purchaser.

Even if the vendor has not claimed capital allowances and the issue of capital allowances is not addressed at the time of sale, then the ability for the purchaser or any future purchaser to claim capital allowances is lost forever.

Therefore, it is important to correctly address the capital allowances position during the property transaction which puts a greater emphasis on correctly answering replies to Commercial Property Standard Enquiries (CPSE). In the past it was common approach to leave the questions inadequately answered however they must now be detailed, and specifically address the questions being raised.

It is no longer acceptable to reply with "The purchaser should make their own enquiries" or "Not Applicable."

There is greater emphasis on all professionals acting for the purchaser to consider capital allowances however, arguably, the onus will rest on the legal and accounting professional to ensure that the correct documentation is in place at the time of the transaction. Failure to address the new changes could result in tax relief being lost for the purchaser. However, with the correct procedures in place, which include conclusive answers to the CPSE enquiries and correct contract documentation within the Sale and Purchase Agreement (SPA), then both parties can deal with the actual mechanics of claiming and pooling the allowances after the purchase.

Due diligence is not the same for all scenarios

Any form of due diligence in a transaction is bespoke to that transaction and as such one set of answers will not fit all scenarios, this is also true for the capital allowances due diligence. To get the answer wrong could result in a loss of tax relief, which may prove to be expensive to the client and even possibly to the advisors.

Some of the wider considerations required when considering capital allowances include:

- Does the vendors capital allowances claim restrict them to just plant and machinery allowances?
- Did the vendor who owned the property before April 2008 claim capital allowances on the installation of general lighting, external lighting and cold water systems or can the purchaser make a separate claim for integral features?
- Have any other forms of capital allowances (other than plant and machinery or integral features) been claimed? For example, industrial buildings allowances, hotel allowances, enterprise zone allowances, research and development allowances or business premises renovation allowances.
- Does the vendors capital allowances claim relate to an apportionment of their property purchase price or does it relate to a refurbishment / fit out after they had purchased?

The above scenarios along with others would help determine the best course of action.

Case studies:

Case 1: Buying from someone who has not claimed capital allowances

Our client, a property investor, made his first investment subsequent to the introduction of the new rules on June 2014. It related to the purchase of a £400,000 office which had originally been acquired by the vendor around January 2007 for £500,000. The vendor confirmed that no capital allowances have ever been claimed.

Step 1: we provided the correct documentation to be inserted into the SPA, allowing the parties to undertake the capital allowances valuation soon after purchase and agreeing to enter into a CAA2001 s.198 election for the allowances to be transferred to the purchaser.

Step 2: we prepared a capital allowances valuation for the vendor based on their £500,000 purchase price, they then pooled the allowances and signed the election for the full amount of £125,000 of allowances to be transferred to the purchaser.

Step 3: given the purchaser was the first to have incurred expenditure after April 2008, they are the first to be entitled to claim integral features. We undertook a second valuation based on the apportionment of the £400,000 they paid for the property. This resulted in capital allowances of £45,000.

Combined, the purchaser was able to claim £170,000 worth of capital allowances. In this particular scenario under the 'old rules' the allowances would have been in the region of £100,000-£120,000.

Case 2: Buying from an administrator

More often than not, administrators will be reluctant to "confirm or deny" if any capital allowances have been claimed. This has a crucial impact on how one could adequately complete their due diligence.

In one particular scenario our client was acquiring an office block and the administrator refused to set out the capital allowances position. In this scenario our client was able to complete the transaction as our due diligence confirmed that the vendor was holding the asset as trading stock and as such they would not have been able to claim capital allowances.

We asked the administrators to confirm that the vendor was a developer which then allowed our client to base their capital allowances valuation on an apportionment of their own purchase price.

If the vendor had not held the asset as trading stock, our client would have considered reverting to the tax tribunal in order to claim their capital allowances. The changes in legislation include provisions to deal with capital allowances when neither party can agree the value of allowances to be transferred and hence, provided we have raised and documented the correct questions and answers within the CPSE enquiry and reply stages, there should be resource to bring the matter to the first tier tax tribunal after completion of the sale.

How can we help with your due diligence?

We do not believe in a 'one size fits all approach' and those who ask for 'standard wording / clauses' should review these with caution. We provide a pro-active, inquisitive and detailed due diligence aimed at quickly ascertaining the correct capital allowances position for our client. Our capital allowances due diligence will include:

- reviewing clauses within the purchase agreement to ensure that they allow for what the parties to the contract intend and have agreed to;
- reviewing or helping to answer replies to CPSE to ensure that the responses are sufficient;
- if required, review previous ownership history, to provide an indication of whether any claims are likely to have been made;
- if capital allowances have been claimed by the vendor, review the basis of the claim to ensure that it has been maximised;
- provide relevant contract wording for the SPA; and
- review the capital allowances entitlement, providing a suitable CAA2001 s.198 election to allow for the allowances to be transferred to the purchaser.

Sunil Sharma – Head of Capital Allowances
sunil.sharma@msnorthwest.co.uk

Michael Robertson
michael.robertson@msnorthwest.co.uk

6th Floor Blackfriars House
The Parsonage Manchester M3 2JA
T +44 (0)161 832 4281
www.moorestephens.co.uk/manchester

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