Property fit-out bonanza

Nolan Masters sets out how the new super deduction and special rate allowances will affect property owners, occupiers and investors.

In an unexpected offer of generosity, as part of the spring Budget, temporary 'super' capital allowances were given royal assent on 10 June 2021 with a view to kick start the post Covid-19 recovery.

There are two temporary first year allowances (FYAs) for new capital expenditure incurred from 1 April 2021 to 31 March 2023, for contracts entered into after 3 March 2021, namely:

Capital allowance	*Rate of relief*	*Examples*
Super deductions (SDs)	130% for main plant & machinery pool expenditure	Firefighting systems; security systems; data installation; furniture, fittings and equipment; welfare facilities
Special rate (SR) allowances	50% for special rate expenditure	Lifts; lighting; heating, ventilation and cooling systems; thermal insulation; water systems

The allowances are claimable by corporate taxpayers and include non-resident landlords (who have to be corporates), but not individuals and partnerships. Note that the latter can still benefit from the standard rates of relief plus the annual investment allowance (AIA) which stands at £1m for expenditure on both main pool and special rate pool items until the end of December 2021, after which it drops back to £200,000.

The super deduction and special rate allowances must be claimed in the year of expenditure, otherwise the benefit is lost. Early tax planning will therefore be key to ensuring the right information is collated and entitlement issues addressed up front. There is also the potential for partial clawback of the 30% added relief for super deductions, if the asset is sold within the period in which the temporary relief ends.

Key points

- The super deduction and special rate allowances must be claimed in the year of expenditure.
- All fixtures do not qualify for the same rates of allowance.
- Construction costs will need to be fully assessed to claim at the correct rates of relief.
- Bear in mind the corporation tax rate increase from April 2023.

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Investing in property – who benefits?

In the draft legislation, HMRC included the restriction under general exclusions in CAA 2001, s 46(2) for any plant or machinery which is leased.

However, an amendment to clause 9 of the Finance Bill (now FA 2021, s 9) will enable background plant and machinery in leased buildings to qualify for both the super deduction and special rate allowance. This is a welcome change and allows for investors in property to be able to take the full benefit of these temporary reliefs.

Example

Based on year 1 benefit for a company spending £10m on qualifying main plant and machinery assets:

Before 1 April 2021	After 1 April 2021 – with super deduction
Deducts: Using the annual investment allowance (£1m)	Deducts: £10m x super deduction of 130% = £13m
Deducts: (£10m – £1m = £9m) using standard annual writing down allowance at 18% x £9m = £1.62m	
Tax saving: £2.62m @ corporation tax rate of 19%	Tax saving: £13m @ corporation tax rate of 19%
Saves £497,800	**Saves £2.47m**

The following sets out how the legislation applies to different investors in property.

Owner occupier

The general principle of claiming these temporary first year allowances, as with standard capital allowances, is that entitlement arises as a result of incurring capital expenditure, owning a relevant interest in land and those qualifying fixtures are then used for a qualifying business activity.

Single purchased equipment is straightforward to identify and capture; the challenge will be for any building works which consist of expenditure on fixtures that qualify for different rates of capital allowances. For example, an electrical lump sum cost can contain, say, fire alarm expenditure which qualifies for the main pool super deduction and general lighting which would qualify for the special rate allowance. Further, builders work in connection, such as ceilings, could then be apportioned across both pools.

With the introduction of structures and buildings allowances (SBAs) in October 2018, it is only too easy to allocate capitalised land and buildings expenditure to the SBA pool, rather than undertake a detailed cost analysis. Not only is this approach incorrect, since a claim for SBAs must exclude any expenditure which qualifies for plant and machinery allowances but, unlike plant and machinery allowances, the value of claimed SBAs is fully clawed back on disposal. With the introduction of these temporary FYAs, ignoring the requirement for a more detailed cost analysis can lead to a significant loss of tax relief both during ownership and at the point the asset is disposed of.

Tenant fit out

Similar to owner occupiers, as long as the tenant has incurred capital expenditure, it is the tenant who can claim the temporary first year allowances for qualifying fixtures installed in the leased property space.

The exception is where a landlord is to provide a capital contribution towards the tenant's fit out works. In that event, the tenant will need to net off the contribution in calculating their available claim.

Under the capital allowance legislation, it is the landlord who is deemed to have incurred the contribution expenditure and who has the potential to claim the temporary first year allowances on background plant and machinery. Landlord and tenants should now consider as part of the lease negotiations, who is best placed to incur the expenditure within the leased demise and then allocate the contribution in the most favourable way.

For leasehold interests where there is no disposal value, the claimed SBAs will not be clawed back, but there will still be the need to ensure that the plant and machinery expenditure is claimed at the higher rates of relief.

Fixtures which are replaced like for like with no improvement have the potential to be taken as a revenue expense, however it is likely to be more beneficial now to claim it as capital and qualifying for the super deduction at 130%.

Operator

For operators of property, whether that be for a hotel or serviced office, the ability to claim super deductions and special rate allowances is determined by which entity has

incurred the expenditure. In an opco propco (operating company/property company) structure, it will often be the case that the propco will incur the construction expenditure with a management agreement granted to an operator. Here, the entitlement to take the benefit of any capital allowances sits with the propco.

> "Landlord and tenants should now consider as part of the lease negotiations, who is best placed to incur the expenditure."

With the likelihood that some landlords will be currently assessing how best to reposition their assets, how those assets are to be operated will be central to those decisions. Obtaining an understanding of the capital works and the entitlement position is vitally important to do before the expenditure, to determine which party is to benefit from the available tax reliefs, particularly with increased tax rates around the corner.

It should be noted, that under leases of background plant or machinery, the propco is restricted on claiming capital allowances on trade specific expenditure such as for retail displaying goods and the manufacture of goods or materials. It should therefore be considered as to which party is best to pay for these items.

Property investor

For investors in property, the initial draft legislation made for disappointing reading, with the restriction on leased plant and machinery. Roll forward a few weeks and, after much lobbying, HMRC made a surprise u-turn. It removed the restriction, replacing it with a revised clause giving the ability for investors to claim on background plant and machinery.

As a result, all investors that are subject to corporation tax, including non-resident landlords, could now benefit from claiming both the super deduction and special rate allowance on any planned property expenditure before 31 March 2023. Given this fiscal announcement was all about stimulating investment, this is welcome news indeed.

For those investors who have yet to put a building contract in place, the timing of the expenditure will dictate the extent to which these temporary tax reliefs can be claimed. As long as the expenditure is incurred or at the very least is 'unconditional' by 31 March 2023 and to be paid within four months, a claim on these temporary FYAs can be made.

Most building project expenditure will now qualify for multiple rates of capital allowances, either 130%, 100%, 50%, 18%, 6%, 3% or zero, plus there is 150% for land remediation relief. The issue for clients and their advisers, is how to unlock the tax relief from the base construction cost information provided. Building projects are by their design often complex and the pricing does not match the tax analysis required to claim the capital allowances fully. Instead, it requires an expert with knowledge of the building process and hence why HMRC advises that a capital allowances specialist be used who can correctly value the capital allowances into the appropriate pools of tax relief.

It is worth noting that these temporary FYAs do not apply to second-hand acquisitions unless the property is acquired unused from a developer. Further, while residential property is excluded from capital allowance claims, by virtue of CAA 2001, s 35, it is possible to claim super deductions and special rate allowances on care homes, student accommodation and build-to-rent sectors, while needing to consider the definition of a dwelling in *Revenue and Customs Brief 45/10*.

Unlike the AIA, there is no restriction on the amount of expenditure that can be claimed either as a super deduction or special rate allowance. Both must be claimed in the year of expenditure as a FYA, so the relief can be used either to mitigate tax payable in that year end or if loss making, the losses can be increased and rolled forwards or temporarily carried back for up to three years.

Conclusion

With HMRC removing the leased plant and machinery restriction, it has expanded the ability for both businesses and property investors to claim significant tax relief in bringing forward certain capital investment over the next two years. There was always going to be a need to rebalance the books however, and this will come about by the increase in corporation tax rising from 19% to 25% from 1 April 2023 for those companies whose profits exceed £50,000. For qualifying capital projects, the claiming of 'super' capital allowances represents an opportunity to generate tax relief, which will help boost cash flow now and in the future. ●

Planning point

Note that the super deduction and special rate allowances do not apply to second-hand acquisitions unless they are bought unused from a developer.

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