

# Allow me

On 1 April, the capital allowances regime will change, with potential implications for every buyer and seller of commercial property. Clive Curd provides a step-by-step guide for solicitors acting for either party



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Change is coming. From 1 April 2014, the capital allowances (CAs) legislation, which has already been published, will affect how buyers and sellers deal with commercial property transactions. This, in turn, will involve all their advisers, and especially their lawyers, who are central to the process.

What is also apparent is that clients expect advisers to give advice on all aspects of their affairs, or to refer to an appropriate adviser when it is not their area of expertise. While lawyers will have an understanding of the legal entitlement to, and contractual requirements for CAs, the ability to check prior claim history back to the first use for each fixture and to then value and quantify the level of allowances does require the input of a CAs specialist. This point was highlighted in the recent high-profile case on giving advice, *Mehjoo v Harben Barker* [2013] EWHC 1500, where a competent accountant was told by the judge that he should have advised his client to “take tax advice from [specialist tax advisers]”.

The new legislation, introduced through sections 187A-B of the Capital Allowances Act 2001 (CAA 2001) (brought in by the Finance Act 2012), is intended to stop what HM Revenue & Customs believes are erroneous claims being made by some taxpayers. The legislation is drafted to force the issue to be dealt with at the point of sale. No longer can CAs be viewed as an afterthought, because of the risk to both the buyer and seller of losing out on the benefit.

The key change for clients is one with far-reaching implications: if CAs are not elected over at the point of sale, then the buyer, and all future buyers, will be prevented from claiming any CAs.

On a transaction, where an item of plant and machinery is within section 187A, the past owner (current owner) is treated as owning the fixture. For a future



claim to be made, the following criteria must be satisfied:

- a) *pooling requirement*: expenditure must be pooled within their accounts (pooling does not mean making a claim, but identifying the value to be elected over in the accounts); and either
- b) *disposal value statement*: there must be a written statement of the disposal value of fixtures that at an earlier point had to be brought into account; or
- c) *fixed value requirement*: there must be an agreement between the two parties, formally agreed within two years, of the value to be transferred between them (typically via an election under section 198 of the CAA 2001).

In this article, I provide a step-by-step guide to CAs on commercial property transactions for practising lawyers acting for either buyer or seller.

## PRACTICE POINTS: ACTING FOR THE SELLER

Raise the issue of CAs with your client as soon as possible. Failure to do so could result in delaying the transaction, or risk a financial loss to the client. If unsure, refer to a specialist CAs adviser.

Your next step will depend on whether the client has claimed, and whether they are a taxpayer. They will be either a), b) or c).

- a) If they have claimed (and therefore are a taxpayer), protect their position with a section 198 election.
- b) If they have not claimed, and they are a taxpayer, then they must calculate the value, and pool prior to sale (the seller, not the buyer, must carry out the calculation, because it is submitted in the seller’s accounts). They then have the option to either retain the benefit of allowances, or pass on the value by negotiating within a section 198 election.
- c) If they haven’t claimed, and don’t pay tax, then a written statement is to be provided to the buyer, and / or section 198 elections entered into by the last seller to have claimed allowances.

Next, advise the client (if in doubt) to contact their accountant and / or a specialist CAs adviser to provide the answers to the pre-contract

enquiries. Stating 'N/A', not available or not applicable, or leaving answers blank, will not be accepted by a buyer. All expenditure and back-up detail must be included.

Finally, add in contract clauses and supporting documentation, a section 198 election, or written statement. Failure to do so could result in a loss for your client, breach of contract, and / or a loss for the buyer.

### PRACTICE POINTS: ACTING FOR THE BUYER

The first point is the same as for the seller: raise the issue of CAs as soon as possible. Again, failure to do so could result in delay or financial loss. If unsure, refer to a specialist CAs adviser.

Then consider whether your client can benefit from CAs. Even if they are a non-taxpayer or their business is loss-making, it is still better to have CAs than not, to extract value on the future sale.

If they are a taxpayer, then provision must be made as part of the heads of terms to be negotiated.

Then check the seller has answered the pre-contract enquiries sufficiently. The Commercial Property Standard Enquiries (CPSEs) have been rewritten to provide the buyer with details of each previous expenditure point. Do not accept N/A, not available or not applicable, or blank answers; this does not provide sufficient information for your client to make an informed decision.

Consider advising the client to have the answers looked at by a CAs specialist who understands both the legislation and how to check quantum. For more details on this point, see the common errors section, below.

Finally, you need to agree to contract clauses and section 198 elections or written statements. The clauses must provide for the seller pooling their allowances, and the election or written statement must also be correct.

### COMMON ERRORS

The following are examples of where clients and advisers get it wrong.

#### Sellers

- No section 198 election is made, or it is made incorrectly, resulting in pay-back of all tax saved.
- Only a partial claim is made, forgetting the original purchase or subsequent refurbishments.
- The value of CAs within the property is not taken advantage of as a method of increasing the sale price.

#### Buyers

- A £2 election is automatically accepted, without reviewing the basis of the prior claims and providing a full list of assets.
- A £2 election is agreed from a non-taxpayer.
- A £2 election is believed to prevent any further claims.
- The buyer misses out on claiming on unrestricted plant and machinery.

Capital contributions are outside the scope of section 187A but pass as tax written down value.

### COMMON ENQUIRIES

Information that will now commonly be required from the seller as part of answering the revised CPSEs will include:

- previous written statements and / or inherited signed section 198 elections with details of previous transactions;
- information on known capital contributions paid to tenants;
- copies of licences to alterations by tenants;

- detail of works carried out to the property; and
- confirmation of any known prior CAs claims submitted on the property.

The buyer may ask for more detail, in addition to the information provided by the seller, to assess the availability of any additional claims to be made. Property owners must therefore be more assiduous than ever in keeping records of all the expenditure they incur on the property.

Where there has been a refurbishment, extension, and / or tenants' fit-out,

buyers should ask for CAs claims on any expenditure after acquisition.

In the event of a future disposal, the level of detail that should ideally be retained includes: ledgers to identify direct purchases; dates of valuations to contractors; and professional fees, plus building contracts, contract tenders, final accounts and work package details for expenditure items that require allocation to the correct pool.

This level of detail is required, as even if the current owner does not

claim, that owner will have to calculate these allowances on disposal, in order to pool and elect on these items so the buyer can claim, or if the buyer is a non-taxpayer, to assist the future sale process.

### Example of an acquisition

The property is an office building, bought for £2m from a taxpayer, and therefore within section 187A. The seller must pool any allowances that they were entitled to claim, based on their expenditure, and then enter into a section 198 election for an amount between £2 and the value of the pooled expenditure. The seller originally constructed the property for £1m. The seller can pass across any amount (based on 45% qualifying) of between £2 and £450,000, subject to negotiation between the parties.

### SUMMARY

Many property owners and investors do not have knowledge and experience of the CAs at the point of a transaction. The seller providing wrong or missing information could have ramifications at a later stage. A buyer not understanding what detail to ask for and requesting pooling before sale will risk losing tax relief.

Every property has a different CAs history, and it is critical to allow sufficient time within the transaction to establish the entitlement to claim, and then retrieve the necessary information to quantify the level of CAs to be elected over within the purchase contract.

Lawyers are central to the transaction process, and therefore must advise their clients to take specialist advice where they are unsure of the position, or risk their clients missing out on the benefit.