Strategic *Allowance*

Clive Curd, Director, Veritas Advisory Limited, helps us to understand how to make the most of the often overlooked Capital Allowances on certain property types.

With a low understanding of their applicability and restrictions, Capital Allowances are often overlooked when people are considering purchasing or investing in commercial properties. However these are something owners of offices, retail space, factories or even some holiday lets have the opportunity to take advantage of and they are worth taking the time to understand.

Who can claim this tax relief?

- If you are a tax payer/company that has purchased and or refurbished the property
- If you receive rental income on property investment trade
- If you are using a property for your own business, freeholder/leaseholder
- If you satisfy the holiday let requirements
- If you establish any prior claims history of previous owners

What properties does the tax benefit apply to?
A claim can be made subject to any restrictions on an acquisition and also a refurbishment of your property. This can be on commercial property, offices, retail space, shopping centres, factories, warehousing, care homes, hotels, doctors etc. You cannot claim on residential, except for care homes, hotels and student accommodation (restricted) and holiday lets.

The level of benefit will vary depending on how much you spend, the specification and any restrictions.

So what items can typically qualify in a property?
These items are not necessarily all allowable, nor are they the only items that can be claimed, but the below gives an indication of what qualifies:

- Electrical power and lighting
- Hot and cold water pipework and tanks
- Boilers, ventilation and air conditioning
- Kitchen fittings, sanitaryware
- Fixtures and fittings such as cupboards, shelving, carpets, signs
- Fire alarm, security, lifts, data and audio installations

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When can you claim?
A common misconception, if you have owned the property for years, is that the allowances must have been used up. This is not necessarily the case; you never lose the benefit of Capital Allowances as long as you still own the property. The claims may not be added into tax returns from years ago, but can be used in recent tax years or whenever you want to going forward.

What information do I need to do this?
Often record keeping of expenditure is not detailed enough to list which items can qualify. However, a retrospective claim can still be made where the total expenditure is known, by a recalculation of the works and items that qualify. This will involve a detailed survey of the premises to establish both the value of qualifying and non-qualifying expenditure.

What happens when I sell my property?
A quirk of Capital Allowances is that on disposal of a property, it is possible to retain the benefit and there is no claw back of tax as long as you take the correct advice at the time of sale. A common misconception is that if you sell at a profit there is a capital gains tax increase, but that is not the case.

What does it mean in the current market?
If you spend anything on the property types indicated earlier, then you may be able to claim a Capital Allowance tax relief. You may hold the property as an individual, a company or partnership, or part-pension. The only ownership method that does not quality is if it is purely held in a pension.

There is a social and political movement to increase the tax revenues on the profit made in connection with property. Top-end, expensive properties are highlighted by the media as avoiding tax. There does, however, seem to be a forgotten issue that many properties, with the exception of central London, have decreased in value, selling at a loss over the last few years.

The market has changed in the way it operates; typically a property investor puts 30-40% of equity into a deal, with the balance made up of debt finance. The attractiveness of this being the ability to gear up the amount of investment and use the debt finance as a cost deduction. New rules for residential properties in April 2017 will restrict the amount of debt repayments individuals can offset against their income. There is a consultation for the same to be applied to commercial property. The consultation for commercial is to reduce the ability to offset these allowable deductions. This, ▶

coupled with the reduction in loan-to-value, does mean that on a property which generates an income there is more taxable profit, and therefore more tax to pay.

One of the few ways to mitigate this is to claim a tax deduction on qualifying fixtures and fittings and plant and machinery via the Capital Allowances regime. This legislation has been around for many years, and was introduced to stimulate investment. Although traditionally thought of as items used for manufacturing, this had been extended over the years to cover additional assets and increased types of properties, such as industrial buildings and hotels. These days it is more commonly known as plant and machinery.

The benefit

To illustrate how the Capital Allowances claims work in your tax return, see the following example for each property type with and without Capital Allowances.

	Office		*UK Holiday Let*		*Overseas Holiday Let*	
	Without CAs	*With CAs*	*Without CAs*	*With CAs*	*Without CAs*	*With CAs*
Rental Income	600,000	600,000	30,000	30,000	40,000	40,000
Allowable costs						
Management	-60,000	-60,000	-3,000	-3,000	-4,000	-4,000
Repairs	-30,000	-30,000	-1,500	-1,500	-2,000	-2,000
Interest	-120,000	-120,000	-6,000	-6,000	-8,000	-8,000
Capital Allowances	0	-296,000	0	-75,000	0	-11,000
Profit before tax	390,000	94,000	19,500	0	26,000	15,000
Tax at 45%	175,500	42,300	8,775	0	11,700	6,750
Tax Saving	0	133,200	0	8,775	0	4,950
Increased return year 1		76%		100%		43%
Tax saved after 5 years		**260,000**		**33,000**		**20,000**
Tax saved after 10 years		**349,000**		**33,000**		**32,000**

The table makes a number of assumptions on income and costs, and assumes AIA is available, a 45% tax rate, and no other deductions. For the UK Holiday Let, the unused allowances can be carried forward to the following year.

Capital Allowances, although highly complex, offer significant tax savings. As a rough indication, if you were to own any of the following properties, the total amount of tax you could potentially save is indicated in the table below:

Property Type	*Purchase Price*	*Capital Allowances*	*45% tax (cash) saving*
Office	*£5million*	*£1,000,000*	*£450,000*
Retail High Street	*£5million*	*£375,000*	*£168,750*
Industrial	*£2.5million*	*£250,000*	*£112,500*
UK Holiday Let	*£500,000*	*£75,000*	*£33,750*
Overseas Holiday Let	*£750,000*	*£112,500*	*£50,625*

Assumed 45% tax payer

The tax saving is spread over a number of years to try and mirror the depreciation of the asset. However, as with most tax reliefs, there are different rates for every item. In addition, the first £200,000 of Capital Allowances in the current year will qualify at 100%, known as the Annual Investment Allowance.

Capital Allowances	*£1,000,000*	
Annual Investment Allowance @ 100%	*(£200,000 x 100%)*	*= £200,000*
Annual writing down allowance @ 12%	*(£800,000 x 12%)*	*= £96,000*
Total first year allowances		*= £296,000*
Tax rate @45%	*(£296,000 x 45%)*	*= £133,200*