

Construction expenses

Clive Curd takes a practical look at how the new structures and buildings allowance works.

The structures and buildings allowance (SBA) was introduced in the autumn 2018 Budget after a recommendation by the Office for Tax Simplification in its report *Accounting depreciation or capital allowance* (tinyurl.com/otsadcajune). On 18 June, HMRC published its response (tinyurl.com/hmrcsbarespjun) to the consultation and revised legislation further to the draft legislation published in March (tinyurl.com/draftsbamar) for the SBA (CAA 2001, s 270AA to s 270IL). A new s 270AA(4) has been added to the effect that, if a building or structure is demolished, the person ceases to be entitled to the SBA.

The new tax relief is aimed at relieving the capital expenditure on buildings and structures for which there is no allowance, excluding anything that can qualify for plant and machinery allowances. The previous relief of this kind was the industrial buildings allowance (IBA), although it was limited to occupational use and was removed in 2011.

At first, it seemed the new relief would be straightforward to calculate, but the detail in the draft legislation shows otherwise. The allowance is available for all commercial buildings and structures except for those defined as in residential use, mainly dwellings (see definition in s 270CF). Final legislation is expected over the summer, although it applies to all contracts entered into on or after 29 October 2018.

The allowance is calculated at the annual rate of 2% of the cost to construct a building or structure; it can be claimed in a tax return in the year that the building is brought into first use. Assuming the draft legislation remains broadly as it is, the allowance can be applied not only to new developments but also to refurbishments, conversions, extensions, fit outs, leaseholder improvements, as well as capital contributions (CAA 2001, s 538A).

The taxpayer must have the relevant interest under which the expenditure is incurred. The relief is available for UK and



overseas structures and buildings, when the business is within the charge to UK tax.

Calculating the SBA

At face value the SBA is simple to calculate. The value is the total cost of the construction of building or structure, assuming the relevant interest and qualifying activity conditions have been met, less other capital allowances and ineligible expenditure, multiplied by the annual allowance of 2%.

Delve into the detail however and it becomes apparent that consideration needs to be given to the practicalities of calculating the SBA. It is not possible simply to apply the total construction cost because there are several expenses that are disallowed.

Previous allowances, such as IBAs, gave the taxpayer the choice of which allowance to claim by maximising the plant and machinery allowances instead of IBAs. However, the new legislation does not permit all expenditure to be claimed as SBA, instead it is necessary to calculate the excluded expenditure.

Examples of excluded expenditure include:

- acquisition or alteration of land;
- market value rule;
- provision of plant and machinery; and
- revenue expenditure.

Acquisition of land is the actual purchase plus all related costs such as fees and stamp duty.

Additionally, any expenditure incurred on or in connection with seeking planning permission is excluded. Typically, an architect is employed to design, apply for planning, revise and, after planning is granted, carry out further detailed design as well as project manage during the construction phase. Fees will have to be split between each activity for SBA purposes.

Alteration of land, including landscaping that does not create a structure, is excluded but the preparation of a site for the purposes of the construction is allowed. Costs incurred in remediating the land or altering land in a derelict state are also excluded and relate to the tax relief for land remediation (CTA 2009, s 1146 conditions A to C and s 1146A conditions A and B).

Key points

- The structures and buildings allowance applies to new contracts from 29 October.
- Residential buildings do not qualify.
- For the claim, it is necessary to calculate expenditure that is excluded.
- The claimant must satisfy an allowance statement.

Distinguishing between site preparation and remediation can become blurred.

Under the market value rules, expenditure incurred on constructing or buying a property is excluded to the extent that it exceeds the market value or 'the normal and reasonable cost to incur the works', something which is open to interpretation.

Items qualifying for integral features or plant and machinery allowances cannot be allocated as SBAs.

The SBAs do not qualify for annual investment allowances. The consequences of allocating plant and machinery allowances to SBAs are two-fold. First, it reduces the cash flow by not using the annual investment allowance. Second, because SBAs have to be repaid on disposal, it increases the tax paid.

Specific provisions in the draft legislation cover developers, the cost of construction and the lessor of the capital sum. This allows the correct person to claim the SBAs whether the building is vacant or in use, for both a speculative developer or a forward-funded arrangement.

SBAs can be claimed only after the building has been used. This creates additional record-keeping requirements, especially when a building has multiple tenants, floors or when there are multiple properties in a single development. The correct basis for determining the date of first use is unclear. If, for example, it is the lease and a tenant is already in occupation fitting out their space should the practical completion date be used?

It also uncertain as to the evidence the landlord and tenants should retain to provide this date. Evidence of the date will be important for future transfers of ownership.

Another area of complexity is mixed-use developments where there are shared plant and common areas and how the calculation will have to be split between use.

For projects overlapping several accounting periods, the draft legislation has been revised. It attempts to reduce the complexity by defining the timing of the expenditure and how expenditure should be treated on either the latest day of qualifying construction or the first day of the chargeable period.

Evidence of qualifying expenditure

The burden of proof for self assessment is on the taxpayer to have the evidence to support a claim. The draft legislation has provided supplementary provisions as to the evidence required for qualifying expenditure. If the taxpayer does not satisfy an 'allowance statement', the qualifying expenditure is deemed to be 'nil'.

Section 4 lists what must be included in the 'allowances statement':

- date of written contract;
- amount qualifying expenditure incurred on construction; and
- date of first use.

These requirements are not prescriptive enough to determine the level of evidence. It is unclear, for example, the detail required should one acquire a property from a developer in the future but information from the original construction is not readily available. It would be helpful to have the opportunity to revisit the total cost and estimate

the breakdown of costs, based on reasonable assumptions, similar to a CAA 2001, s 562 apportionment for plant and machinery claim, which is accepted by the Valuation Office Agency in a universally recognised format.

Practical issues will also arise on mixed-use properties, with both commercial and excluded residential use, projects with phased developments, overlapping accounting periods and the issue of determining from when 'first use' applies, both on new build projects and when fit outs are undertaken.

For example, an office building with residential above, will have the following permutations:

<i>Element</i>	<i>SBA qualifying</i>
Site acquisition	Disallowed
Finance costs on land	Disallowed
Associated fees and stamp duty	Disallowed
Planning fees	Disallowed
Design fees	Part allowed/apportioned
Main contractor preliminaries	Part allowed/apportioned
Land remediation (LRR)	Disallowed
Site preparation	Part allowed/apportioned
Building cost, building and structure	Claim SBA
Building cost, plant and machinery (PMA)	Disallowed
Building cost, shared cores	Part allowed/apportioned
Building costs, BWIC (Builders Work In Connection with Cost)	Part allowed
External works, general	Claim SBA
External works, landscaping	Disallowed
Overheads and profit	Part allowed/apportioned
Professional fees	Part allowed/apportioned
Direct external fees qualifying for LRR/PMA	Disallowed
Direct external fees non-qualifying LRR/PMA	Part allowed/apportioned
Direct costs such as IT, furniture, signage	Disallowed
Finance costs on construction	Disallowed
Agents and letting fees	Disallowed
Capital contribution, PMA	Disallowed
Capital contribution, building and structure	Claim SBA

What is defined as 'residential'?

Residential buildings are excluded. The legislation states that a building or structure is in 'residential use' if it is:

- a dwelling house;
- residential accommodation for school pupils;
- student accommodation – with further definitions of purpose built and converted accommodation;
- residential accommodation for armed forces;
- a home or other institutions providing residential; or
- a prison or similar.

However, there are exceptions when the occupiers of the accommodation receive personal care by reason of old age, disability, alcohol and drug dependency and mental disorder. Nursing and care homes, and other similar medical facilities do qualify for the allowance.

Hotels are not mentioned specifically, but these will qualify, as will aparthotels. As with all property types, the actual use may change and there will no doubt be grey areas to consider as to the definition of what is and is not a residential exclusion.

In the residential and build-to-rent or the private rented sector, while the dwelling itself is excluded, plant and

Transactions

Owner	Transaction	SBA
Non-taxpaying fund A	Develops property in 2019	No claim
Pension fund B	Acquires in 2030	No allowance statement, no claim
Investor C	Acquires in 2035	Wants to claim

machinery can be claimed in the common areas. This will not apply to SBA, creating other allowances with different rules and no common method for taxpayers is a further complication.

Transactions

The standard commercial property standards enquiries form will have to be revised with additional question on SBA. Further, an allowance statement is required stating the date of the contract, value and date of first use.

From a practical point of view, all property owners should keep records to pass on the unclaimed SBAs. Unfortunately, as often happens in transactions for capital allowances on plant and machinery, information is not always transferred. Non-taxpaying investors have no requirement nor any incentive to retain these records or to pass on the allowance statement. During the ownership of an asset over many years, it is likely that this information will be missed.

In the *Transactions* scenario how can investor C provide the necessary evidence to support a claim? In theory non-taxpaying fund A will have passed the required evidence to pension fund B, and on to investor C.

Transactions that have significant SBAs between experienced investors will have processes for the allowances statement, but it is the smaller and less experienced investors where there could be a lack of due diligence and the knowledge of what should be done to transfer the benefit from one to another.

There may be an argument with the change in capital gains tax for overseas investors and the restriction of losses, that non-taxpayers will see the benefit of trading a property with substantial cash flow benefits.

It is hoped that as this new allowance is passed from seller to buyer, greater due diligence will take place on property transactions, and clients' accountants and tax advisers will become more aware of the process.

There are specific draft clauses (s 270BC, BD and BE) that address the treatment of SBAs when they are acquired from a developer, both used and unused, as well as from a sale other than by a developer which is unused.

Sales

When an asset is sold, the current owner will cease claiming the allowance, and the purchaser will take over the remaining

Planning point

Accurate record keeping is key in all tax areas and the structures and buildings allowance is no different. Make sure clients know what information is required to meet the conditions for claiming this new relief.

Onward sale

Construction cost	£12,000,000
Less: ineligible expenditure	£2,000,000
Qualifying SBA	£10,000,000
2% annual written down allowance	£200,000
Corporation tax saving at a 19%	£38,000
Tax saving after ten years	£380,000/3.8% of the cost

allowances until the end of the 50 years or as long as the asset is in existence.

In *Onward sale* the first owner will claim £200,000 a year. The property is disposed in year 10. The new owner will then continue to claim £200,000 for the remaining 40 years, or until a future disposal event.

The sale creates a disposal, as with other capital allowances, but it differs because the amount claimed – ten years at £200,000 = £2,000,000 – is added to the sale proceeds for capital gains tax purposes (TCGA 1992, s 37B(2)) and is therefore a cash flow incentive rather than an actual tax saving. For plant and machinery, a seller can, on disposal, choose an alternative apportionment by means of a CAA 2001, s 198 election, and agree the value with the buyer at any value between £1 (per pool) to the total value of the claim or the sale price, whichever is the lesser. Therefore the tax savings are retained by the seller. For SBAs there is no such mechanism and the draft legislation requires the tax savings repaid by adding to the sale proceeds for the capital gains tax calculation.

Take away for readers

To claim SBAs the following key points should be taken into account:

- Prove the date of the contract is after 29 October 2018.
- Determine whether the property is defined as a dwelling.
- What is the first use for each part of the property?
- Collate detailed costs and construction information to break down costs.
- Collate professional fees and direct cost to establish eligibility.
- Consider any restriction when acquiring from a developer.
- On transactions – obtain the allowances statement.
- Maintain records for each claim for disposal calculation.

The draft legislation also includes the general anti avoidance provisions, as well as the treatment of VAT on costs.

It will be interesting to note any further changes to the draft legislation, and how quickly advisers will get up to speed with collating the evidence to meet HMRC's requirements. ●

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