ICAEW
REPRESENTATION 21/19

CAPITAL ALLOWANCES FOR STRUCTURES AND BUILDINGS

Issued 4 February 2019

ICAEW welcomes the opportunity to respond to the Technical Note, Capital allowances for structures and buildings, published by HM Revenue & Customs (HMRC) on 29 October 2018. This representation is further to the separate meeting we had with HMRC and HM Treasury in December 2018 in which members related their own experiences and views.

This response of 31 January 2019 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, ICAEW Tax Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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ICAEW Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 **icaew.com**

MAJOR POINTS

1. ICAEW welcomes the opportunity to respond to respond to the Technical Note, Capital allowances for structures and buildings.
2. We welcome the reintroduction of a tax relief for the construction cost of structures and buildings and note that it has been made effective from the date its announcement on 29 October 2018.
3. A change of this magnitude should have begun with a full and open discussion with specialists from business before being implemented. While we understand the government's desire to encourage businesses to begin qualifying investment as soon as possible, delegating the specifics of this relief to secondary legislation, does not give the clarity and certainty the tax system needs.
4. We are particularly concerned about the absence of balancing adjustments on disposal. Although the simplicity of the remaining allowances passing to the next owner is attractive in straightforward cases, for many commercial situations this creates far more complexity. In particular, the need to retain original construction costs for 50 years once a property has changed hands and been added to several times, or where the property is overseas.
5. The grant and assignment of leased property produces some complexities of its own, and the interaction with capital gains for wasting leases are not completely explained.

GENERAL COMMENTS

Lack of proper consultation

6. We welcome the reintroduction of a tax relief for the construction cost of structures and buildings. The new Structures and buildings allowance is effective for costs of constructing new structures and buildings under contracts incurred on or after 29 October 2018.
7. In December 2017, the Government published The new Budget timetable and the tax policy making process in which it set out how the move to a single fiscal event cycle impacts on the tax policy making and consultation process. It also reaffirmed the government's commitment to the principles set out in Tax policy making: a new approach, published in 2010, to create a more predictable, stable and simple tax system.
8. We are concerned that although welcome, this important change to the capital allowances system should have been accompanied by full and open discussion with specialists from business before being implemented.

Lack of parliamentary scrutiny

9. The legislative framework for this relief is contained within a single brief clause in Finance (No3) Bill 2017-19 which, at the time of writing this response, is supplemented by a brief technical note.
10. We understand the government's desire to encourage businesses to begin qualifying investment as soon as possible, and its concern that a period between announcing the change and its practical implementation would inevitably have led to some contracts being delayed. However delegating the specifics of this relief to secondary legislation, which will undoubtedly be supported by guidance, neither of which is available until some months after the effective date, has much the same effect. This does not give the clarity and certainty the tax system needs, nor does it give parliament the opportunity for adequate scrutiny of the detail.

Complexity of capital allowances

11. The Office of Tax Simplification (OTS) in its report Accounting depreciation or capital allowances? Simplifying tax relief for tangible fixed assets, published in June 2018 summarises its conclusions saying

12. '…nothing in this review has made the structure of the CA regime seem simple. It is complicated and at times unfair as between different businesses. The only benefit of the way that tax relief is currently given is that it exists already and some people are familiar with it. The CA system should be improved.'
13. We do not consider the details of the SBA released so far, nor its implementation, to have simplified the capital allowances system.

Using the Industrial buildings allowance as a template

14. The Industrial Buildings Allowance (IBA) was abolished in 2008. While IBAs were restricted to particular types of buildings, the system had the advantage of having been defined and tested over many years. When we met representatives of HMRC and HM Treasury teams responsible for the new SBA policy, the 20 or so capital allowances specialists we assembled to represent ICAEW agreed **unanimously** that the reintroduction and tweaking of the old IBA legislation would be preferable to a proposed new allowance, with a completely new set of rules, and the inevitable teething problems that would result. It is highly likely that the biggest part of these teething problems will be where the legislation doesn't interact as intended with other existing tax legislation, but which the IBA legislation had already dealt with.
15. The key change which would be needed to the old IBA legislation, if this is used as a basis, is whether the new SBA should require qualifying activity or physical use for eligibility? Should the new allowance be given when the building is used in the course of a qualifying activity, as plant and machinery allowances (PMAs) are, rather than being given on physical use as the old IBA's were. The latter seems to be the current intention which may mean a time delay to large projects and may not encourage the speculative investment in structures and buildings that Government is looking to encourage.

Period of relief

16. The current proposal will spread SBA relief on a straight line basis over 50 years. If the policy is to incentivise and encourage capital expenditure on buildings, this is not likely to be a particularly attractive incentive. In our view, the relief would provide a better incentive if a higher initial allowance was given in the earlier years. Such an approach (first year allowances) was used in respect of IBAs. We appreciate that this would increase the cost of the relief, so a balance would need to be struck.

Reduction to special rate pool WDA

17. We are concerned that this new relief is being financed in part through the reduction to the rate of WDA on special rate pool assets which is being reduced to 6% per annum. This was the rate used when long life assets were first introduced to cover assets with an expected economic life of over 25 years. Many of the mechanical and electrical installations within a property will have a life expectancy of no more than 15 to 20 years so the allowances will continue long after the assets to which they relate have been destroyed.
18. See also our comments regarding the SBA being merely a cash flow benefit. This, taken together with the reduced special rate pool relief seems disadvantageous overall.

Disposal

19. The intention of the SBA is that there will be no balancing adjustment on sale or disposal of the asset. Our understanding is that any SBA already given will however be used to reduce cost when the taxpayer's chargeable gain is calculated. This would in fact mean that rather than being a new additional allowance, the SBA is merely a timing benefit, with any benefit being clawed back when the property is sold. It is not clear that the impact assessment showing the predicted cost to HMT takes this into account.
20. We understand that the final interaction with chargeable gains is still being considered.

Extension of the SBA to dwellings

21. We would welcome clarification of the policy purpose of SBA in respect of dwellings. If the policy is to provide relief in all cases of commercial expenditure on structures and buildings, then in principle it might be reasonable to include dwellings, for example large scale schemes in the private rental sector and blocks of student accommodation. For further discussion, see paragraphs 25 et seq below.

Buildings which are demolished

22. We are unclear how the SBA can continue to be given for a building which has been demolished.
23. While it may be workable if 'use' is not physical use (as was the case with IBA's) but is rather use for the purposes of a qualifying activity (as in the case for plant and machinery allowances), we question whether it is practical. The proposal as described will result in allowances being claimed on assets that no longer exist as the SBA's will attach to interests in land. Presumably, bare land could then be sold with the benefit of shadow SBA's from previously demolished buildings. How would any CGT adjustment be applied to the next owner of the land who goes on to sell the property for a gain in the future?

Availability of information to second and subsequent owners – record keeping

24. Vendors of properties with an SBA attached will need to keep detailed records to substantiate claims to the allowance by later owners of the property. There will need to be a statutory requirement for these to be part of the package of documents available on sale. As the relief will be for 50 years, the document trail will also need to last 50 years. This is administratively challenging and while advances such as block chain might eventually be a way to record these costs, we question whether this administrative burden might prove too onerous for commercial reality at this time.

To ensure the necessary exclusion of residential use, are there specific types of buildings or activities for which the draft legislation should provide?

25. We understand the policy intent is to give relief for business investment in commercial enterprises, but not for investment in buildings to be let as dwellings. Excluding the entire residential sector will necessarily add complexity to the definition.
26. For example, we understand the intention is that expenditure on a care home is to be eligible, but accommodation for student lettings is not. We understand the differentiating factor behind the policy intent is that care homes offer extra levels of activity, ie, nursing. However we note the NHS Data Dictionary identifies two categories of Care Home, being one with or without nursing care and its definition states specifically 'A Care Home Without Nursing is a Care Home'.
27. Furthermore, the definition of a dwelling is not straightforward and is different for different taxes.
28. As an illustration, we have had several comments from members on the complexity of identifying whether student halls of residence are regarded as dwellings for different taxes.
29. The intention is that student accommodation is to be regarded as residential for the purposes of the SBA. This is contrary to its definition for other taxes.
30. For Stamp Duty Land Tax where different tax rates apply to purchases of residential and non-residential property, we must first consider whether the property is suitable for use as a dwelling to establish which scale of rates applies. While residential accommodation for students is generally regarded as a dwelling, a hall of residence for students in further or higher education is specifically not a dwelling, see Meaning of "residential property" s116(1) to (3), Finance Act 2003. So purchasing a hall of residence attracts lower rates of SDLT.
31. For Capital Gains Tax (CGT), higher rates apply to gains on disposals of dwellings. Para 4 Schedule B1, TCGA 1992 defines a dwelling for CGT, but paras 4(7) and (8) specifically

exclude certain purpose built student accommodation from being regarded as suitable for use as a dwelling. So a purpose built hall of residence which has enough bedrooms and high enough occupancy rates is not a dwelling for CGT purposes.

32. We suggest that a list of existing definitions is provided to accompany the legislation to give clarity.

It has been necessary to reflect situations where the grant of a lease is akin to a sale of a property interest. Is the proposed boundary of 35 years for the transfer of the SBA from a lessor to a lessee appropriate?

33. The rules for leases appear extremely complex and at the meeting we had with HMT/HMRC led to intense debate. We understand that 35 years was selected based on commercial principles, but it wasn't totally clear what these are. The relative balance of capital and income elements is obviously an area where the tax treatment is important, however, the complexity of the calculations seems disproportionate to the sums involved, particularly for smaller transactions.
34. The calculation of the SBA seems particularly problematic where leases of less than 50 years are involved and seems to be caused largely by the absence of a balancing adjustment on disposal.
35. The further test at para 49 of the Technical Note adds complexity and further details are needed on how this will work in different situations. We would like to see the detailed draft legislation and guidance before commenting further.
36. Tenants will frequently be required to undertake to fit out premises even though they may lease the property for only 10 to 15 years. The absence of a balancing allowance or charge on disposal would mean they will not receive tax relief on all of their expenditure. There is a suggestion that a landlord would become entitled to claim any remaining allowances despite not having incurred any qualifying expenditure on the works, which seems counter intuitive and it is unclear how such allowances would be dealt with in any future CGT computation for the landlord.
37. The end of the lease through natural passage of time should not normally result in a CGT disposal, so no effective claw-back of the historic SBAs; this implies the SBAs would be an absolute deduction rather than a timing difference in such cases. Leaving SBAs with whoever incurs the expense would seem to makes the most sense (so not transferring the SBAs between landlords and tenants), although that approach would have the problem of no relief for unclaimed SBAs at the end of a lease lasting less than 50 years.
38. We suggest writing off the SBAs over the lease period rather than 50 years would be a more pragmatic solution than treating the tenant as continuing to be eligible for the SBAs, even though the building has been demolished, and also better than transferring the residue of the SBA to the person who had not incurred the cost.

Wasting leases

39. We are not clear how the capital gains calculation would work for a wasting lease and in particular the SBA deduction from the base cost.
40. The easiest approach would be to reduce the original base cost prior to applying the wasting percentage, but since the SBAs are claimed over the lease period, conceptually it could be argued that the wasting percentage should be calculated on a year-by-year basis for each SBA claimed. In our view, the opportunity should be taken to keep this as simple as possible.

Are there specific issues regarding overseas property that require specific provision in the draft legislation?

41. The record keeping by a previous owner of an overseas property may be insufficient for the UK claimant of the SBA. For example, the residue of relief is available from the date of construction, but the overseas company will have had no incentive to keep records from day one.

The government has proposed a period of disuse during which the structure or buildings retains its eligibility for relief – up to two years ordinarily, or up to five years where it substantially no longer exists following extensive damage. Are there any significant practical problems would prevent the proposed policy from working?

42. We understand that the two year period of disuse is to be viewed within a rolling period of ten years. This was not drawn out in the technical note and we should be interested in understanding how this would work in practice. Were alternatives considered?

43. The restriction for disuse seems to conflict with allowing the SBA to continue after a building has been totally demolished.

44. If a building was in use by multiple tenants, perhaps let floor by floor, the owner would want relief to be considered floor by floor.

45. A deminimis for a part let building then encourages tenants to be moved around between units.

46. Logically, a building is constructed to be used rather than to stand empty, so being empty is the exception. The moment a building is available for use, rather than on completion of the build should be the starting point for the allowance. Extraneous factors can prevent all or part of a building opening on time, for example, a housing estate not being built, or a road or train service being delayed.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

- Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
- Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
- Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
- Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
- Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
- Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
- Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
- Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
- Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
- Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).