

Practical TAX Newsletter

Capital allowance anti-avoidance

Steven Bone explains the proposed anti-avoidance rules.

Background

On 31 May 2011 HMRC published a consultation document proposing changes to the general plant and machinery capital allowances anti-avoidance legislation (see: www.lexisurl.com/CAAs). Consultation responses were requested by 31 August 2011, and legislation is expected to be included in the 2012 Finance Bill.

The proposed changes apply to 'relevant transactions'. Currently, these are plant and machinery sales, hire purchases, or assignments of hire purchase contracts (CAA 2001, s 213) between connected persons. Also sale and leaseback transactions are included, as are transactions designed to obtain capital allowances, that is, where it appears to HMRC that the obtaining of allowances is the 'sole or main benefit' of the transaction (CAA 2001, ss 214-216).

Existing anti-avoidance rule

Capital Allowances Act 2001 Chapter 17, Part 2 (Plant and Machinery Allowances 'Other Anti-Avoidance') contains rules designed to counter transactions that attempt to accelerate, 'refresh' or 'inflate' capital allowances. These rules prevent the taxpayer from claiming an accelerated annual investment allowance or first-year allowance (CAA 2001, s 217). They also seek to restrict the 'qualifying expenditure' upon which the buyer may claim writing-down

allowances (CAA 2001, s 218).

Under the basic rule of CAA 2001, s 11 'qualifying expenditure' is, broadly, capital expenditure incurred on the provision of plant or machinery for the purposes of the taxpayer's 'qualifying activity' (that is, business or trade). The taxpayer must own the plant, or be deemed to own it for tax purposes.

The CAA 2001, Part 2, Chapter 17 anti-avoidance rules operate by limiting the buyer's qualifying expenditure to the seller's disposal value, if this is less

than the buyer's expenditure. This works because the disposal value tables in CAA 2001, s 61(2) and s 196(1) direct that for market value sales the disposal value should be the 'net proceeds of the sale'.

This means that under CAA 2001, s 562 there is a 'just and reasonable apportionment' of the purchase price. In practice, in cases where the amount apportioned to the plant is at least as much as (and often more than) the seller's apportionment upon acquisition, then it is limited by CAA 2001, s 62 to the qualifying expenditure incurred by the seller (ie, the seller's full original cost). So the seller suffers a full claw-back and the buyer can claim on that same 'capped' amount going forward, without any 'ramping up' of the claim being possible.

However, in circumstances where the seller has not claimed any capital

"HMRC's concern is that some taxpayers have been abusing the capital allowances rules."

CONTENTS

Capital Allowances

Changes to plant and machinery allowances
p153

Compliance Centres

The role of HMRC's Compliance Centres
p155

Newsfile

HMRC service standards
Mirrlees review
Manufactured overseas dividends
Tax treaty override
Goodwill and properties
Retail prices index ■ Online security
Finance Bill 2012 ■ Old technology
HMRC publications ■ HMRC forums
HMRC manuals ■ Employer guidance
Regulations ■ International tax
p156

Points of law

Trustees were negligent
Directors liable for PAYE
Penalty avoided
Trade losses allowed
No evidence of loan
p160

allowances and so is not required to bring into account a disposal value (CAA 2001, s 64(1)) this rule has no effect. Therefore, additional requirements stipulate that if the seller is not required to account for a disposal value then the buyer may only claim capital allowances on the smallest of the following three amounts (again subject to these being lower than the buyer's actual expenditure):

- the market value of the plant or machinery (at the time of the transaction in question);
- the capital expenditure originally incurred on the plant or machinery by the seller; or
- the capital expenditure originally incurred on the plant or machinery by any person connected with the seller.

An exception to these rules is where the seller is a plant manufacturer or supplier, and the plant has been sold to the buyer in the normal course of the seller's business, as long as it has never been used before that contract or sale (CAA 2001, s 230).

The perceived problem

HMRC's concern is that some taxpayers have been abusing the capital allowances rules, and the existing anti-avoidance legislation is not drafted widely enough to catch all of the transactions that HMRC believe it should. So the rules need to be tightened to protect the Exchequer.

For example, one particular issue of concern was a marketed avoidance

scheme that sought to take advantage of the manufacturer's and supplier's exemption to enable companies to artificially accelerate claims to first-year allowances and obtain early tax relief. Example 1, provided by HMRC, illustrates this.

HMRC's proposals

HMRC proposes making four changes to the legislation:

1. Claiming inflated or excessive allowances will not necessarily be the 'sole or main benefit' of such transactions because they typically involve the purchase of an asset for commercial purposes (albeit, structured in a tax-efficient manner). So the Government intends toughening this threshold to become 'main or one of the main'. HMRC also propose introducing a purpose test that defines a 'transaction to obtain allowances' as one where it appears that a main purpose is for anyone to obtain allowances.
2. The definition of a 'relevant transaction' (that is, sales, hire purchases etc) will be expanded to include all transactions where a buyer is able to benefit from a contract providing that the seller shall, or may, become the owner of plant on the performance of a contract (that is, all hire purchase or similar, including novations). The amount of expenditure incurred will be the claimant's capital expenditure under that contract.
3. Where the legislation applies, the

amount of capital expenditure may be restricted to the asset's market value. Where arrangements are put in place to reduce the value of the asset to the buyer (such as a lease or other encumbrance), they will be taken into account. Likewise, arrangements which increase the value will be disregarded.

4. The exclusion for manufacturers and suppliers will be wholly repealed. In a surprise announcement (see: www.lexisurl.com/12Aug), this was partially repealed for expenditure incurred from 12 August 2011, such that an annual investment allowance or first-year allowance is no longer available.

Comment on HMRC proposals

Retrospective

While it is difficult to object to HMRC closing loopholes against out-and-out attempts at avoidance, it is disappointing that they partially repealed the manufacturing exemption before its consultation period ended. Also, it is worrying that, at the same time, the Government announced it was to consider whether the legislation should have retrospective effect. This cannot be welcome. Businesses should be taxed on the law in place at the time of their actions, and to do otherwise can only have a damaging effect on confidence in the stability of the tax system.

Repeal of the manufacturing exemption risks genuine transactions being caught with unfair or absurd results. For example, if ECA-qualifying equipment is bought from the manufacturer by a connected party, but fails to qualify for a first-year allowance, then the buyer would be worse off than if it had been purchased by a third party.

Innocents caught

HMRC maintain that the changes are only aimed at artificial transactions. However, the proposed legislation is potentially worded too widely and could easily catch entirely 'innocent' commercial transactions. A simple example relates to enhanced capital allowances (ECAs), which are a type of 100% first-year allowance for certain

Example 1

Company X is to buy, from the manufacturer, costly purpose-built plant. Without any tax-motivated restructuring it would be paid for in instalments over its four year construction period and 100% first-year allowances could be claimed on each instalment.

To accelerate allowances, steps are inserted into the transaction. First, the rights and obligations to acquire the plant are assigned to a subsidiary procurement company. Secondly, a hire purchase agreement is put in place between X and its subsidiary with an upfront balloon payment of almost the entire expenditure. X then becomes entitled to claim accelerated first-year allowances on the full expenditure when paid at the start of the contract, rather than in instalments. Because the companies are connected, ordinarily s 214 and s 217 would deny first-year allowances. However, the subsidiary's plant supply business means that s 230 overrides this.

'green' plant. The availability of ECAs could well be one of the main reasons for acquiring an asset rather than another, but it could hardly be HMRC's intention that such purchases should be regarded as avoidance.

Furthermore, rather than targeting transactions to 'obtain allowances' the legislation should preferably focus upon situations where the 'sole motive' was achieving a (sharply defined) 'tax advantage'. For example, perhaps obtaining a greater allowance. Simply getting an allowance should not be regarded as tax avoidance.

Instead of ruling out first-year allowances altogether the legislation could perhaps limit the benefit to market

value. A partial precedent exists for this in CAA 2001, s 70C.

Revise the wording

Many routine commercial and legal procedures could conceivably constitute 'arrangements'. A more appropriate term would perhaps be a 'scheme'.

If HMRC are particularly concerned to catch contract novations in relevant circumstances, then they could consider using the word in the definition of 'relevant transaction'.

Valuation problems

Market value is a tricky concept to define. It can have a different meaning depending upon whom you ask, what

purpose it is for and what method you use. A good example is the ongoing controversy about the valuation of goodwill in trade-related properties. HMRC might be better off steering away from the use of market value concepts by defining that these should only apply where steps have clearly been taken to manipulate the value purported to exist within the scheme in question. **TPT**

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