

Brief Encounter

Guidance in HMRC Brief 66/08

Previous articles ('Integral features', *The Tax Journal*, 17 September 2007 and 'A cosmetic exercise', *The Tax Journal*, 28 January 2008) have discussed the changes made to the system of capital allowances by Finance Act 2008 (first projected in February 2007), in particular the introduction of a new category of plant – so-called 'integral features'.

The bare rules leave unanswered many questions of definition and application. After a wait of almost two years since the changes were first announced and nearly a year after they took effect, proposed guidance has now been issued, in the form of HMRC Brief 66/08 and draft updates to the HMRC Capital Allowances Manual.

The Brief is entitled 'Capital allowances: Finance Act 2008 changes: draft guidance and related matters', which may cause difficulty in a few years' time to advisers trying to decide the treatment of slurry pits (a matter unrelated to the Finance Act changes but which is given almost twice as many words in the Brief). The Brief also deals with student accommodation, another issue unrelated to the Finance Act. Again, in years to come, advisers may have difficulty locating the source of HMRC's changed interpretation.

THE BIG ISSUE – FA 2008 CONSULTATION

The Brief comments on changes to the capital allowances rules made by Finance Act 2008 and invites comments to be made by 10 February. The previous consultation was thought by many commentators to be something of a cosmetic exercise (see *The Tax Journal*, 28 January 2008) and it may well be felt that commenting on the present document would serve little purpose.

For one thing, it should be remembered that the *Manual* is merely a reflection of HMRC's view of the legislation – it does not of itself carry any legislative weight. Indeed, the *Manual* is at fault, even incorrect, in a number of other key areas. No taxpayer or adviser should ever concede a point on what is said in the *Manual*, without going back to statute or case law.

Martin Wilson, of the Capital Allowances Partnership LLP, comments on HMRC's latest pronouncements on capital allowances including guidance on the integral features regime introduced by FA 2008

BACKGROUND

Finance Act 2008 made a number of changes to the Capital Allowances Act 2001, notably:

- a reduction in the main rate of capital allowances on plant and machinery from 25% to 20% for the main pool
- the introduction of a new annual investment allowance (AIA), effectively a 100% allowance for expenditure on plant and machinery of up to £50,000 a year
- the introduction of a new classification of 'integral features' of a building to apply to new and some replacement expenditure, attracting a reduced allowance of 10%
- the phased withdrawal of industrial

commentators reacted sceptically to this, noting instead that the changes (particularly the rate reduction) were aimed primarily at recouping the tax lost as a result of reducing the main rate of corporation tax: good news in the headlines; bad news in the small print. The HMRC Manuals should concentrate on being a technical resource, avoiding political 'spin'.

Integral features

The most keenly awaited part of the Brief is HMRC's interpretation of the new integral features legislation. From April 2008 expenditure on integral features

After a wait of almost two years since the changes were first announced and nearly a year after they took effect, proposed guidance has now been issued, in the form of HMRC Brief 66/08 and draft updates to the HMRC Capital Allowances Manual

and agricultural buildings allowances by 2011

- new payable tax credits for businesses that make losses attributable to investment in environmentally beneficial plant and machinery.

The draft *Manual* updates run to 102 pages. The specific changes are not highlighted or explained, which is not particularly helpful to taxpayers and their advisers wishing to assess the changes. Few advisers, other than specialists, are likely to analyse the entire document.

Interestingly, the historical introduction to the *Manual* repeats the Chancellor's claim that the changes have three objectives, broadly (i) to promote investment, (ii) simplification and (iii) fairness. Most observers and

attracts allowances at the reduced rate of 10% per annum. Integral features are:

- electrical systems (including lighting systems)
- cold water systems
- space or water heating systems, powered systems of ventilation, air cooling or purification, and any floor or ceiling comprised in such systems
- lifts, escalators and moving walkways
- external solar shading.

There is little attempt in the *Manual* updates to define what is meant by each of these terms; taxpayers are instead referred to their 'ordinary meaning', which is likely to result in differences of opinion between HMRC and taxpayers. An electrical system, for example, is 'a system for taking electrical power from

the point of entry to the building or structure, or generation within the building or structure, and distributing it through the building or structure, as required'. It does not include wiring and electrical components included in other systems, such as telecommunications or alarms.

Many of the examples given are quite simplistic and do little more than state the obvious but an exception is that relating to replacement of integral features, which is reproduced in Figure 1.

on repairs but also (in the first year at least) 90% of the relief on the £30,000 – if Jonathan is a higher rate taxpayer, that cost will be £10,800. This is difficult to reconcile with the third stated aim of the changes, namely 'fairness'. It would be fairer to exclude from the calculation any expenditure that is demonstrably not part of an ongoing scheme of replacement but merely a reaction to circumstances. One would hope for a common-sense approach from inspectors in such cases.

'Accept that these items are plant:

- central heating systems*
- hot water systems*
- air conditioning systems*
- alarm and sprinkler systems
- ventilation systems*
- baths
- wash basins
- toilet suites.

* Please note – that with effect from 1 April 2008 (CT) and 6 April 2008 (IT) expenditure on these items is separately classified as expenditure on an "integral feature" of a building or structure ... and as such falls to be treated as "special rate" P&M expenditure, entitled to WDAs at the rate of 10% pa in the special rate pool.'

The asterisks and the note are newly added – the remainder is as already existed. This illustrates a rather superficial approach, when with scarcely any more effort, the list could have been expanded to include *all* categories of integral features. As it stands, there is no mention at this stage of electrical or cold water systems, lifts or solar shading. Inspectors, particularly those with less experience, rely on the Manual for guidance. The inclusion of all integral features within this particular instruction would significantly reduce the likelihood of unnecessary enquiries into assets that are now always to be treated as plant.

LAYING IT ON THICK

For reasons which are not clear, as one would have thought that the FA 2008 changes merited a Brief of their own, HMRC Brief 66/08 goes on to discuss at length a couple of relatively uncommon issues.

With all respect to the agricultural sector, the capital allowances treatment of slurry storage facilities is an issue that most taxpayers and advisers are unlikely to come across. However, in a lengthy and detailed analysis the Brief confirms that most elements of slurry storage facilities will be plant but that buildings and structures will not.

STUDENT ACCOMMODATION – HMRC CHANGES ITS VIEW

The final matter dealt with by the Brief concerns the capital allowances treatment of student accommodation. In the words of the Brief, it 'clarifies HMRC's view on the application of CAA01/S35 (no capital allowances for plant and machinery used in a dwelling house) to university halls of residence and similar facilities'.

Whilst many readers may have sympathy with attempts to restrict the possibility of claiming capital expenditure as a repair (though it is not clear whether this was a real or imagined problem), the rather contrived nature of the example given does illustrate how the circumstances 'caught' are more likely to be found in textbooks or in the exam room than in real life

Under CAA 2001, s 33A any expenditure on an integral feature in a rolling period of 12 months is treated as being a replacement (and therefore capital qualifying for the 10% allowances). It has not been generally realised that this rule arbitrarily overturns existing law and practice on the capital/revenue divide, built up over more than a century.

The underlying reason for the expenditure is irrelevant – if, say, the December 08 repairs in the example were required as a result of vandalism, they would nonetheless be taken into account in determining whether not only the £5,000 repairs but also the previous £30,000 should be treated as capital. That vandalism has not only cost Jonathan the extra £5,000

Whilst many readers may have sympathy with attempts to restrict the possibility of claiming capital expenditure as a repair (though it is not clear whether this was a real or imagined problem), the rather contrived nature of the example given does illustrate how the circumstances 'caught' are more likely to be found in textbooks or in the exam room than in real life. Many will feel that s 33A is something of a sledgehammer to crack a nut.

A missed opportunity

Some parts of the draft Manual draw attention to the rather limited nature of the update. Paragraph 21200 gives basic instructions to inspectors on certain assets which are treated as plant. It reads:

Figure 1: Replacement of integral fixtures

Jonathan designs, makes and sells jewellery. He incurs expenditure on repairing or replacing parts of the central heating system in his large studio/shop. The expenditure he incurs on the system may be summarised as follows:

Date	Repair cost	12 months cumulative expenditure	Replacement cost	% of original expenditure	50% exceeded?
1 April 08	£10K	£10K	£60K	16.66%	No
1 Sept 08	£20K	£30K	£65K	50%	No
1 Dec 08	£5K	£35K (08-09)	£65K	58.33%	Yes
1 July 09	£10K	£35K (1/9/08 to 31/8/09)	£65K	53.8% (of 1/9/08 cost)	Yes
Totals	£45K		£65K	75%/or 70%	Yes

Note: this example is reprinted verbatim as published in the Manual update

What this really means is that in some cases HMRC is *changing* its published view. Inevitably, the change is not to the taxpayer's advantage.

Allowances are not due on plant let for use in a dwelling house. There is no definition of dwelling house but guidance at CA11520 sets out HMRC's view on its meaning. It has for many years stated that, amongst other types of accommodation, university halls of residence are not dwelling houses.

However, the nature of student accommodation has evolved in recent years and so guidance is now being updated to

reflect this. In contrast to old-style halls or colleges, many student residences are now largely indistinguishable from ordinary blocks of flats. It is now HMRC's view that within the flats only the 'communal' areas (such as living rooms and kitchens) are *not* dwelling houses. Outside the individual flats other areas of the building to which tenants do not have access are also not dwelling houses. However, all other areas are dwelling houses. In effect, each student's own private room or rooms will be regarded as dwelling houses, so plant therein will not qualify for allowances (see Figure 2).

This is a common-sense view, although there will be grey areas. The changed treatment extends to other types of multiple-occupancy accommodation, such as those provided to key workers. Any taxpayer or adviser currently submitting a claim will need to claim only on the new basis and current-year claims for expenditure brought forward will also need to follow the new guidance.

CONCLUSION

It is of course welcome that HMRC is consulting on its guidance to inspectors. However, the proposals contain no particular surprises and it is questionable whether taxpayers will derive much benefit or certainty as a result. It is also worth remembering that although inspectors often treat the manuals as 'gospel', they are just HMRC's interpretation and do on occasion approach a subject from HMRC's own, rarely taxpayer-friendly, perspective. They do not replace statute and case law.

Martin Wilson is a partner in the Capital Allowances Partnership LLP (www.capallow.com) and author of *Tottel's Capital Allowances: Transactions & Planning*.

Figure 2: Student accommodation

A student accommodation block has three floors, each with ten en-suite 'study bedrooms' that are individually lockable. Each floor also has a kitchen and TV room which are for the use of the ten occupants. The building has air-conditioning equipment located in the attic and a boiler located in the basement – only maintenance personnel have access to these areas.

In this example the kitchen and TV room are communal areas and not dwelling houses. The stairs and corridors which give access to other areas are also communal and are not dwelling houses. Tenants do not have access to the roof and attic and so they are not dwelling houses. However, the individual study bedrooms are dwelling houses.

Note: this example is reproduced from the HMRC Brief

Tax Lecturers and Writers

Looking for a change of direction?

Tolley® Tax Training is looking to recruit full time and part time **tax lecturers and writers**.

- Previous experience required.
- Excellent salary, benefits & working environment.
- A chance to join a high performing team delivering high quality training.

To be considered, please email your CV to simon.groom@lexisnexis.co.uk

SOLUTIONS FOR KNOWLEDGE-DRIVEN PROFESSIONALS
Client Development Research & Knowledge Solutions Practice & Productivity Management Risk & Compliance LexisNexis®

Tolley® Conferences 2009

Tolley® Conferences cover key strategic topics relevant to tax professionals in industry and practice, through a comprehensive series of high level conferences, workshops and breakfast briefings. As the UK's leading provider and publisher of tax information we are uniquely placed to attract expert speakers who bring a wealth of knowledge and practical experience to each event.

VAT Planning and Anti Avoidance	London	24th Feb
Corporate International Tax Planning	London	25th Feb
Private Client Tax Planning	London	26th Feb

For further details on any of the above events please visit: www.conferencesandtraining.com
Email conferences@lexisnexis.co.uk
Or call 020 7347 3574

SOLUTIONS FOR KNOWLEDGE-DRIVEN PROFESSIONALS
Client Development Research & Knowledge Solutions Practice & Productivity Management Risk & Compliance LexisNexis®