



Chartered
Institute of
Taxation

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: post@ciot.org.uk

Capital allowances for structures and buildings

Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 We refer to the new Structures and Buildings Allowance (SBA) announced by the Chancellor at Budget 2018 and the Technical Note published on Budget Day which outlined the new relief. Representatives of the Chartered Institute of Taxation (CIOT) met with HMRC and HMT on 14 January 2019 to discuss the details of the SBA and the questions posed in the Technical Note. Our comments below build on the discussions at that meeting.
- 1.2 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 1.3 Our stated objectives are for a tax system which includes a legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences and also a system that has greater simplicity and clarity, so people can understand how much tax they should be paying and why. As we explain below, in our view, the proposals for the SBA could be improved to better achieve these objectives.

2 The policy aims and overall approach

- 2.1 We note the policy aims of the SBA outlined in the Technical Note and also explained at our meeting; these are to encourage investment in the construction, and renovation, of structures and buildings intended for commercial use, and, by giving relief for expenditure on this, to address a gap in the current capital allowances system and improve the UK's international competitiveness. The Technical Note also references the recommendation by the Office of Tax Simplification (OTS) in its report on *Accounting*

depreciation or capital allowances? Simplifying tax reliefs for tangible fixed assets published in June 2018 (the OTS Report) to widening the current scope of capital allowances.

- 2.2 We welcome this policy objective and the giving of relief for this type of business expenditure. We agree that relief through the capital allowances system (as long as that continues to be the main mechanism for relieving capital expenditure on physical assets) is a sensible way to provide tax relief for expenditure on the eligible construction costs.
- 2.3 However, this policy objective also underlines the basic point that there is a conflation in Government thinking between, on the one hand, capital allowances as incentivising expenditure and, on the other, capital allowances as the method of giving relief for types of genuine business expenditure.
- 2.4 With regard to the former of these aims, it is currently questionable whether the complexity being built into the proposals effectively distinguishes what the Government wishes to incentivise from that which it does not, nor is it sufficiently generous to achieve the aim. For various reasons discussed at the meeting, some of which are highlighted below, the SBA will very often deny relief to some of the costs associated with providing premises for commercial activities. Whilst we understand the need to limit the relief and not make it available for residential property, we believe there are some categories where further consideration should be given to the availability of the relief as set out below.
- 2.5 With regard to the latter of these aims, the basis of the OTS's evidence was that if one was to start again, the result would probably be to have tax deductible depreciation but that a wholesale change to accounts depreciation was probably not possible, or worth it, given the existing complexity of the rules. However, the aim should be for capital allowances to follow the accounts so far as possible, that is to say a preference for using accounts based distinctions where possible, rather than increasing tax-only ones.
- 2.6 The inherent complexity emerging from the Technical Note is further explored and demonstrated in the points raised below.
- 2.7 In any event the current proposals for the SBA are, in our view, over complicating matters. The policy aims could have been achieved by a simpler approach of incorporating the relief for this expenditure into the existing capital allowances available.
- 2.8 Although it is correct to say that the OTS recommended widening the scope of capital allowances to include the expenditure on buildings that will now qualify for the SBA, it is also true that the OTS recommended reducing, or at least not increasing, the different types of expenditure and classes of assets that have to be identified for tax purposes, as distinct from the treatment of that expenditure/assets in the accounts, in order to simplify the regime overall. The SBA does the opposite by creating new categories of expenditure – separately for the structure or building, and then for any subsequent capital expenditure on it - which will have to be identified and tracked for tax purposes.
- 2.9 This measure was announced at Budget 2018 alongside a reduction in the capital allowances available for 'special rate expenditure', which includes integral features in buildings. It is not clear to us why it would not have been possible to have given relief for the newly qualifying expenditure on the construction of non-residential structures and buildings by reference to everything treated in the accounts as a building – thereby combining this relief with the special rate pool – with an adjustment to the special rate if appropriate to ensure that it is affordable for the Exchequer. This would have eliminated the need for yet another set of rules for yet another asset class within the capital allowances regime.

- 2.10 However, we note that the decision has been made to have a new relief for a separate class of structures and buildings. We suggest that it should be possible to remove much of the detail and complexity from the current proposals, which are unnecessary and go beyond what is required to support the policy aims. The policy aim is to stimulate expenditure on commercial (or non-residential) structures and buildings. This aim could be achieved to the same extent by simply giving the SBA to the person who incurs the expenditure at the proposed rate of 2% over 50 years. It does not seem necessary for the relief to 'follow the structure or building' in order to achieve the aim of incentivising investment in the construction, and renovation of commercial structures and buildings, as that only applies to the person carrying that out (a requirement around a short period of ownership/use to prevent anti-avoidance could be considered). This approach would remove the complexities around future use of the structure or building or those arising as a result of a future transfer of the property, in particular relating to the information required to claim the SBA. We recognise that this approach does not give any relief corresponding to the depreciation of the second and subsequent owners, and so does not achieve the secondary policy aim of capital allowances being the method of giving relief in respect of genuine business costs incurred. Though if the new allowance became regarded as a stable feature of the landscape one might expect some reflection of that in the market price for buildings.
- 2.11 This approach would require a decision as to whether to link the 50 year deduction right to a trade or business, or to an individual taxpayer or company. Thus there may have to be rules around what happens with transfers of trade, changes in the nature of the trade or business accompanied by changes of ownership. It may be that this results in some of the 50 year stream falling away in many cases; but this would assist with costings and is likely to happen for different reasons (for example the unavailability of information in the future) under the approach envisaged.
- 2.12 We urge the Government to consider whether a simpler, more streamlined approach to the SBA is possible.

3 Broader Government policy aims

- 3.1 The OTS Report (in paragraph 5.29) referenced the suggestion that a widening of scope of capital allowances '*could be directly linked to the attainment of other government objectives, for example by linking the writing down rate to the energy rating of the associated building*'.
- 3.2 In particular, the current proposals for the SBA is not taking the opportunity to incentivise a sustainable approach to expenditure on buildings. This seems to be an opportunity missed, particularly considering that enhanced capital allowances are soon to be withdrawn. Once this occurs, the only incentives to make buildings sustainable are regulatory ones (for example, minimum EPC ratings in the sale and leasing of buildings).
- 3.3 The introduction of the SBA could be a good opportunity to incentivise a sustainable and more rounded approach to buildings generally, especially as new building methods tend to take a holistic view and look at the whole building design and concepts rather than its component parts. Linking higher capital allowances to buildings verified as being sustainable, such as those with the highest rating tiers within schemes such as BREEAM, would incentivise investors to use the latest technology available and produce better-quality buildings.

- 3.4 This would tie in with the Government's stated green agenda and the requirements, for example, of the 2008 UK Climate Change Act and its legally binding carbon budgets, or, at a more local level the aims of the Mayors of London and Manchester wanting their cities to be zero carbon by 2050 and 2038 respectively.
- 3.5 Other Government policy aims are discussed more specifically in relation to dwellings in paragraph 5.6 below.

4 Record keeping /information required

- 4.1 As we discussed at some length at our meeting, although not inherently complicated, the information that is required to be kept in relation to the SBA will be substantial and burdensome for businesses, not least because of the very long time period over which the relief is to run.
- 4.2 The issue is exacerbated when the position of a buyer or subsequent claimant of the relief is considered. There are a variety of situations (for example, sellers not within the charge to UK tax, or sales by administrators/liquidators, and the specific example included at paragraph 39 of the Technical Note of structures and buildings acquired from the Crown) where it is not difficult to see that an owner/seller of a structure or building will not have any incentive to record and/or retain and/or provide the necessary information relating to the SBA which would be required by a buyer in order to claim any remaining SBAs. The view at the meeting was that, while useful, the availability of capital allowances does not generally impact on price, nor impacts on a decision whether or not to acquire a particular structure or building. Thus improving the marketability of the structure or building does not appear provide much incentive to retain the necessary information.
- 4.3 It was suggested that the position regarding the availability of the necessary information would be improved if the statute set out very clearly what was required and in what form, even going so far as to require and determine the form of an annual statutory statement to be kept of the relevant expenditure, start date of qualifying activity for SBA purposes and record of use of the building. This would then be readily available for a buyer in the event of a sale.
- 4.4 Clarity around what is required, particularly if this is linked to the corporation tax return, may bring the software providers on board to build the reporting requirements into relevant accounts and tax return packages, making it easier for taxpayers to comply with the reporting necessary to claim the SBA.
- 4.5 In addition, if the relief is to run with the building, we would also encourage the Government to consider allowing a buyer of an existing building to use some form of estimate of original cost where the details of the actual historical cost are not available from a seller. Alternatively, particularly in circumstances cited in paragraph 39, where the seller is not within the charge to UK tax, allowances could be given in respect of the purchase price (minus land element).

5 Dwellings

- 5.1 It is intended that expenditure on residential property and other buildings that function as dwellings will not qualify for the SBA. It was noted that there are several definitions of what is a dwelling throughout the UK tax code, as well as provisions that categorise types of property for tax purposes.
- 5.2 At the meeting we discussed the definition of infrastructure set out in TIOPA 2010 section 437; it was suggested that anything that would be considered to be infrastructure within that section should qualify for the SBA.
- 5.3 It was noted that this definition would encompass student and army accommodation, as well as prisons. The Technical Note currently envisages that these types of buildings will not qualify for the SBA. We agree with the comments made at the meeting that these types of accommodation are inherently different from a family home; for example, the extent to which student accommodation and prisons are intended to be used for long term residence. In particular, student accommodation is often used outside of term time to accommodate people other than students and in this sense offers a similar quality of accommodation to a hotel rather than a dwelling. In addition, in some respects the type of accommodation offered by care homes – in terms of communal areas - are similar to prisons. It is intended that hotels and care homes will qualify for the SBA.
- 5.4 We discussed alternative approaches to determining whether a property is ‘commercial’ or ‘residential’ for the purposes of whether it should qualify for the SBA, including following classification pursuant to the planning process, or considering whether council tax or business rates is payable on the building.
- 5.5 We understand that HMRC will look at this further and that the outcome will depend on the final decision as to the policy direction, and also an assessment as to the cost to the Exchequer. Overall, the CIOT advocates using an existing definition or rule for the purposes of determining whether a structure or building qualifies for the SBA, rather than introducing another slightly different concept into the tax code. In particular, it would be helpful if the definition of dwelling were consistent across the capital allowances regime.
- 5.6 HMT reiterated the policy aim of this relief, being to encourage investment in business property. It was recognised that the definition of structures and buildings qualifying for the SBA had to reflect this policy aim. However, it was also suggested that the final policy decision should consider the impact on other Government policy areas including:
- Encouraging the building of student accommodation would reduce pressure from students on existing housing stock which is currently occupied by students; and
 - Any new definition of a dwelling for these purposes around whether a person can live an independent life, for example, which could determine whether a care home/village qualifies, should be consistent with Government policy around social care which is to encourage property which facilitates an independent existence.
- 5.7 A further point relating to dwellings which requires clarification is how the cost of building private houses should be treated where this arises as a result of obligations in the planning consent for the building of an office or other commercial building. We suggest that the cost of providing such housing stock could be treated as a facilitating cost of the commercial building, and be added to the overall cost of the commercial building available for the SBA; this would be consistent with the treatment of such costs under the public benefit exemption in the Corporate Interest Restriction rules.

6 Commencement date of the SBA

- 6.1 It is intended that the SBA will be available from when the structure or building is brought into use for the first time for a qualifying activity. This is relatively straightforward in the case of a new structure or building. However, it is intended that the SBA in respect of future capital expenditure on an existing structure or building – for example a refurbishment – should be calculated separately – with a separate period of 50 years etc running for that pot of expenditure. What is the commencement date of the relief for this expenditure?
- 6.2 We assume that if the expenditure follows a period of disuse – or results in a period of disuse, the SBA is available when the structure or building is first brought back into use for a qualifying activity? However, how will the rules work if there is no cessation of use – for example, a rolling refurbishment of a shopping centre? For example, could you confirm that a claim for the SBA can be made in respect of the total amount of qualifying expenditure that has been incurred in an accounting period?
- 6.3 Similarly, it may be necessary to have rules around when a variation to a construction contract becomes a new contract/project/pot of expenditure, which requires a separate calculation.
- 6.4 With regard to ‘first use’ of an asset, we understand that the concept of an asset being ‘brought into use’ for the purpose of making a claim under the SBA is currently intended to be the same as under the old industrial building allowances (IBA) rules. However, we wonder whether this is necessarily the best test to achieve the policy aim of encouraging investment in commercial property development. A developer will incur expenditure in their qualifying business over a project lifecycle (which could be a number of years), but will be unable to claim under the SBA until, say, a tenant has taken occupation. We understand that this long lead in time means it is unlikely the benefits of the SBA would be considered for the purpose of appraising the viability of a development. In addition it is difficult to see how the SBA will stimulate speculative developments, as there is no certainty at the time the development is considered and commenced as to when the SBA will be available.
- 6.5 The SBA would act better as an incentive if it were claimable at an earlier time and during the construction phase. We would support a change to the proposed rules such that the SBA can be claimed from the date at which the expenditure starts to be amortised for accounting purposes.
- 6.6 Alternatively, consideration should be given to linking use of the building with the date of entry into an agreement for lease (which we suggests constitutes use of an asset, as it is evidence of a commitment by the landlord to generate income from it).
- 6.7 However, if the policy is to prevent claims during the construction or development phase, then the practical completion date of the building would also be an appropriate date from which to claim the SBA, as this is easily verifiable and a recognised date for completion of construction projects.

7 Future use of the structure or building and period over which relief is given

- 7.1 As noted at paragraph 2.10 above, in our view this proposal could be greatly simplified by determining whether the SBA is available in its entirety by reference to appropriate use of the building at the outset.

This would achieve the policy of incentivising the desired sort of commercial building - what actually happens to the building at a later date, that is unforeseen originally is irrelevant to this policy aim. In relation to this, we discussed at the meeting that it seems particularly harsh that relief is lost for periods of disuse – as opposed to non-qualifying residential use. We understand that HMRC are considering permitting relief in periods of disuse; we encourage them to do so, in addition to considering simplifying the relief more generally in the manner suggested.

- 7.2 A further point relating to future use, or rather occupation, of a structure or building arises in relation to the treatment of leasing transactions. If a lessee incurs qualifying expenditure it will be entitled to claim the SBAs, but only while it remains a lessee. Paragraph 45 of the Technical Note says that on the expiry or termination of the lease, the entitlement to SBAs passes to the landlord. This seems to be an inequitable result, in that the lessee does not get full relief for its expenditure and the landlord receives a windfall. This anomaly would be removed if, as suggested, the lessee, having incurred the qualifying expenditure, remains entitled to the SBAs regardless of future use or occupation of the structure or building.
- 7.3 More generally, the requirements around the future use of the structure or building reduce the incentivisation effect of the relief because they make it more difficult for developers to be certain that the relief will be available for all of the expenditure incurred, as they cannot be certain as to what it may be commercially prudent to use the building for in future years. Investors generally need certainty that a relief will be available in order to factor it into investment decisions.
- 7.4 Regarding the period for the relief, it may well be the case that there may be many commercial buildings in existence that are more than 50 years old. However, it seems quite likely that fewer of buildings being constructed now will last anything like that long (excepting of course the showpieces like the Shard and the Gherkin). The ever increasing speed of technological advances and ever more whimsical changes in fashion hasten the obsolescence of both products and methods of working, often rendering business premises outmoded in the process. In the case of industrial buildings containing heavy moving plant, the buildings can simply wear out before 50 years are up and their depreciation rates are typically well above 2%.
- 7.5 There may also be investor scepticism around the stability and certainty of this new stand-alone relief, similar to the IBA, and running over such a long period. It is reasonable for investors to consider whether the SBA could easily be withdrawn by another chancellor, as was the IBA. Giving tax relief on building spend through one of the established capital allowances regimes would make this more difficult, especially the withdrawal of future years' allowances that business expected when embarking on the expenditure and accounting for a deferred tax asset.

8 Pre-qualifying activity expenditure

- 8.1 Paragraph 32 of the Technical Note regards expenditure incurred before a qualifying activity has commenced – expenditure will not qualify if incurred more than seven years before the qualifying activity commences. We note that this requirement is in the Finance Bill (at the time of writing) – clause 29(5).

- 8.2 Our understanding is that the seven year rule relates to expenditure incurred before the commencement of the qualifying activity, and is not intended to be a period of seven years before the structure or building is brought into use for the purposes of the qualifying activity.
- 8.3 This is important because construction projects often take place within a special purpose vehicle (SPV), so the relevant qualifying activity (the trade) will be commenced by that SPV in relation to a project. It is also the case that the project period from initiation to practical completion – and, therefore, the use of the structure or building for a qualifying activity, which triggers the availability of the relief – may be more than seven years for a complex project.
- 8.4 Please could you confirm that our understanding is correct.
- 8.5 This time period of seven years could act as a disincentive to commencing/preparing a project if there was no certainty that it would be completed in seven years. We are aware of developments where demolition of a previous building occurred and then the project was paused for some time. For example, in the case of some projects which were paused in 2008/2009, the demolition was more than seven years before the new building was completed; the demolition costs would not qualify for the SBA if a similar scenario reoccurred. It would be preferable, therefore, to have a longer time period of, say, 10 years to make it more likely that all relevant expenditure is eligible for relief.

9 Other points

- 9.1 Paragraph 13 d) of the Technical Note says that qualifying expenditure will include ‘direct costs required to bring the asset into existence’. However, the slides that HMT/HMRC spoke to at our meeting say that the costs of obtaining planning permission will be ‘non-qualifying costs’. It would be useful to have further clarity as to what direct costs are envisaged that will be qualifying expenditure, as an ordinary reading of the words in paragraph 13 d) could lead to a conclusion that planning costs, and, for example, architects work and/or design plans incurred prior to obtaining, and in order to obtain, planning permission would be included as direct costs. Examples of typical eligible costs in this category in guidance would be useful.
- 9.2 Please could it also be clarified whether irrecoverable VAT incurred in relation to other qualifying expenditure will itself be qualifying expenditure.
- 9.3 Please can you clarify that the SBA can be claimed on landlord’s contributions.
- 9.4 We suggest that consideration should be given to allowing relief for demolition costs of commercial buildings generally. These are substantial, very often necessitated by the requirements of the trade and used to be relieved under the IBA regime. We suggest that they are part and parcel of the overall costs of providing premises in which to conduct a trade. If no relief is given for demolition costs when a building has outlived its usefulness and must be demolished for reasons other than to make room for another commercial building, for example, for safety reasons, the result is that there is no tax relief for these genuine business costs.

10 Introduction of this legislation

- 10.1 The Finance Bill (at the time of writing) gives HMRC the right to legislate in respect of the new allowance by way of regulations, subject to a number of requirements for the new legislation specified in the Bill. It is not clear that there is any twilight provision in relation to HMRC's power. We assume that it is intended that once HMRC has laid the relevant regulations, the powers granted by what will become Finance Act 2019 will effectively expire, so that HMRC is not able to make future changes to the new allowance by further statutory instrument, without reference to Parliament in the normal way. Please could this be confirmed.

11 Acknowledgement of submission

- 11.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

12 The Chartered Institute of Taxation

- 12.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,500 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

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