Comments from ICAS

HMRC Technical Note:
Capital allowances for structures and buildings

31 January 2019

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to comment on the Technical Note "Capital allowances for structures and buildings" issued by HMRC on 29 October 2018.

3. We broadly support the introduction of the proposed SBA. However, we are concerned that it is being introduced without following the normal five stage approach to policy development and consultation and through secondary legislation.

4. The first two stages of policy development and implementation of tax policy should involve:
   - Setting out objectives and identifying options
   - Determining the best option and developing a framework for implementation, including detailed policy design.

5. In the case of SBA these stages have been omitted so there is a risk that poor legislation, which
6. causes problems for businesses and does not meet government objectives, may be the result. As this is not anti-avoidance legislation it is difficult to see why a proper consultation process could not have been undertaken.

7. The risk of a poor outcome is compounded by the decision to use secondary legislation. Secondary legislation is not subject to the same level of scrutiny as primary legislation; whilst it may be appropriate for some administrative measures ICAS does not believe it should be used to implement tax changes, such as the SBA, because it lacks both visibility and proper parliamentary consideration.

8. We recognise that the government was keen to provide certainty that the SBA would come into force as soon as possible but we hope that rushed implementation of tax changes will not become the normal approach.

9. It would also be preferable from a user perspective if the SBA legislation could be included in the Capital Allowances Act with other capital allowances legislation. Is there scope for it to be included in a future Finance Act ie replacing the secondary legislation by writing SBA into the Capital Allowances Act?

10. Our comments on specific aspects of the proposals in the Technical Note are set out below.

Administrative requirements

11. The overall aim of the proposed approach to SBA appears to have been to avoid complexity – so, for example, there will be no balancing allowances or charges. However, some aspects of the allowance will impose administrative burdens which may undermine the take up of SBA. Businesses will need to produce a detailed analysis of expenditure on buildings and to maintain detailed depreciation schedules for every building (and separate schedules for any later additional capital expenditure, for example on renovations).

12. This may be a particular issue where the initial expenditure on a building or structure is incurred by the Crown or another person not within the charge to UK tax. SBA will not necessarily be an incentive for such entities to construct buildings or structures (unless the intention is to lease the building to a tenant) – and there may also be little incentive for them to keep detailed records which would enable a later purchaser to claim.

13. A possible simplification in relation to integral features and fixtures is discussed below.

14. There will clearly be additional complexity (and a corresponding increase in the administrative burden) where leasing transactions are concerned. It is not clear from the Technical Note precisely what the mechanism will be for shifting allowances between lessee and lessor.

Rate of SBA

15. The proposed 2% rate for SBA involves a cost write-off over 50 years. However, some structures, for example some used in the provision of alternative energy, have a useful economic life of only 25 years. It appears from the Technical Note that where these structures are demolished and not replaced after, say, 25 years, SBA will continue to be available for the remainder of the 50 year period.

16. The example provided after paragraph 38 makes clear that if a building is heavily damaged and then rebuilt the owner can claim SBA on the remaining original expenditure – as well as on the rebuilding costs.

17. It is, however, unclear what would happen if structures like those referred to above are replaced after 25 years. Would SBA be available on the remaining unrelieved expenditure as well as on the costs of the replacement structures? It appears from paragraphs 37 and 38 of the Technical Note that this may not be the case. This would act as an undesirable disincentive to replacing structures which have been superseded by technological advances after 25 or 30 years – and would encourage businesses to delay investment in more efficient replacement structures.

18. This could be addressed by making clear in the legislation that where a structure is demolished and replaced any original unrelieved expenditure can continue to be written off over the remainder of the 50 year period.

19. In addition to ensuring that there is no disincentive to replacing a technologically obsolete structure it might also be desirable in some cases (such as alternative energy structures) to provide an incentive for earlier replacement. This could be achieved by increasing the rate from 2% to a rate aligned more closely to useful economic life (so 4% in the example given above). Alternatively, at the point where the structure has been demolished and expenditure on the replacement incurred, an accelerated write off of any remaining original expenditure could be permitted. We appreciate that introducing different treatment for different types of structures would add complexity so this would have to be balanced against the expected benefits.

Integral features and fixtures

20. The Technical Note (paragraph 23) makes clear that integral features and fixtures in structures and buildings will not qualify for the SBA. This will require businesses to undertake a detailed analysis of expenditure incurred on a construction project. Under the previous IBAs regime businesses which did not want to carry out such a detailed analysis could simply claim IBAs on the total expenditure – accepting that this would slow down the rate at which relief was given on any expenditure which could have been allocated to integral features and fixtures.

21. It is not clear from the Technical Note why businesses should not be permitted to adopt a similar approach to the SBA – where producing the detailed analysis would be costly and onerous and the business would prefer to claim SBA at 2% on the total expenditure.

22. It is also unclear from paragraph 40 of the Technical Note (acquiring a ready built asset) what the approach to integral features and fixtures should be where a business acquires an unused asset that has already been constructed. The paragraph explains that the cost of the land will need to be separated from the cost of the building or structure. There is no mention of integral features and fixtures but as SBA is stated not to be available on them presumably the intention is that they would also need to be excluded from the amount eligible for SBA?

23. The requirement to exclude integral features and fixtures is likely to cause particular difficulties where the initial construction costs are incurred by the Crown or another person not within the charge to UK tax. Paragraph 39 of the Technical Note states that notional allowances at an annual rate of two percent will be calculated and deducted from the qualifying expenditure. A subsequent purchaser will then be entitled to SBA on the remainder of the qualifying expenditure, reduced by the notional allowances.

24. It appears therefore that the initial owner of the building will have to carry out the analysis of the expenditure to identify integral features and fixtures (even though they are not within the charge to tax and the analysis may be of no use to them if they intend to use the building themselves) if a future purchaser (or possibly a lessee) is to have the option of making a claim. The initial owner will need to be aware of the requirement and prepared to incur the cost of carrying out the analysis.

25. The overall impact of the exclusion of integral features and fixtures may not be regarded as significant by the government, but it is difficult to see why it is required and why businesses could not simply be permitted to claim SBA on the total cost of the building or structure.

Residential property/dwellings

26. The Office of Tax Simplification (OTS) carried out some work on tax definitions as part of its project on Tax Complexity. One of its conclusions was that it would be helpful if definitions were consistent across tax legislation, wherever possible. ICAS supports this approach.

27. There are already several different definitions of residential property/dwellings in different parts of the tax legislation. In the interests of simplification – and to help users – it would be sensible if the definition used for SBA could be the same as one of the other definitions. Creating another different definition adds to complexity and increases the scope for errors.

28. The Technical Note states that the definition of dwelling for the purpose of SBA will be consulted upon before being set out in legislation. We suggest that this consultation should set out all the existing definitions of residential property/dwellings and the government rationale for excluding residential property from SBA - and invite views on which would be the most appropriate definition to use for SBA, which would meet government objectives.

29. The OTS recognised that sometimes definitions may need to be different to meet policy objectives and suggested the creation of a database of all definitions in tax legislation as a readily accessible reference point, not only for policy makers and draftsmen, but also for users of legislation. We support the creation of such a publicly accessible database; the various different definitions of residential property/dwellings (which will potentially be increased if a new definition is created for SBA) provide a good illustration of why such a database would be useful.