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Chapter 4

Purchase of a second-hand building

INTRODUCTION

4.1 The taxpayer incurring expenditure on second-hand assets, whether actual buildings or items of plant included within those buildings, will be able to claim allowances under the same general rules as if he were acquiring the assets brand new. There are, however, certain additional rules to be dealt with, and in many cases the amount qualifying for allowances will be restricted.

4.2 An apportionment of the purchase consideration can often effectively reduce the after-tax cost of a second-hand building by properly identifying all items qualifying for allowances, which might otherwise be ignored in the wider context of a property acquisition.

4.3 Note that expenditure on land does not qualify for allowances. If the price paid for a building includes the cost of the site, the latter must be established (by apportionment if necessary – merely deducting a value for the land element is not acceptable; *Enterprise Zone Syndicate v Inspector of Taxes* [1996] STC (SCD) 336) and excluded from the claim (CA, paras 22040, 31305). The legislation denying allowances for the acquisition of land is scattered throughout CAA 2001, as follows:

- *s 24* – plant and machinery allowances;
- *s 272* – industrial buildings allowances;
- *s 360B* – business premises renovation allowance;
- *s 363* – agricultural buildings allowances;
- *s 393B* – flat conversion allowances;
- *s 440* – research and development allowances.

BUILDINGS

General

4.4 As with newly constructed buildings, the actual structure of a building (the 'bricks and mortar') acquired second hand will only qualify for allowances if it falls within one of the prescribed categories, ie:

(*a*) the building is in an enterprise zone (see **Chapter 9**);

(*b*) it is a qualifying hotel (see **Chapter 8**);

(*c*) the use made of the building is such that it will qualify as industrial (see **Chapter 7**).

Each of these categories of allowance was abolished from April 2011.

4.5 Establishing the capital allowances available when a building is acquired second-hand can be complicated and it is essential that capital allowances due diligence is carried out to review the tax history of the property being acquired and identify any risks and restrictions on the amount that can be claimed. In practice, this is typically dealt with by the solicitor dealing with the transaction. Although a set of British Property Federation endorsed Commercial Property Standard Enquiries exists (form 'CPSE.1') and some solicitors have their own in-house pre-contract enquiry questions covering capital allowances, it is an issue that is all too often ignored or forgotten (or the pre-contract enquiry questions are returned blank or with answers that cannot be logically true), which can leave the buyer exposed to risk. See **Appendix 9** for discussion of pre-contract enquiries.

4.6 This risk extends also to a solicitor or other agent advising on the purchase contract. In *Hurlingham Estates v Wilde & Partners* [1997] 1 Lloyds Rep 525 a conveyancing solicitor had no intention or expertise to advise on tax, but had no formal engagement letter and the court held the solicitor had a duty to advise on tax, notwithstanding his ignorance on the subject. In *Clarke v Iliffes Booth Bennett* (*a firm*) [2004] EWHC 1731 (Ch), [2004] All ER (D) 369 (Jul), a case not directly concerned with capital allowances, it was held that a solicitor had a duty to understand a contract to the extent necessary to give proper advice to the client:

> 'If a solicitor who holds himself or herself out as a specialist in corporate matters is involved in the drafting of an agreement for the sale and purchase of assets, … and the agreement contains tax indemnities, then the solicitor cannot be heard to say that he or she is not under a duty to understand the indemnities and advise as may be necessary in the circumstances, simply because the client is sophisticated and has negotiated the indemnities.'

By extension, a solicitor should not overlook capital allowances clauses, or for example, the impact on capital allowances of any apportionment of the price contained in a contract.

Industrial buildings

4.7 Where an industrial building was acquired second-hand prior to 21 March 2007, the writing-down allowance (WDA) was ascertained by taking

the *residue of expenditure* (see **7.13**) at the date of acquisition and writing it off on a straight line basis over the period beginning with the sale and ending with the 25th anniversary of when the building was first used (*s 311*). Again, where the accounting period was less or more than a year, the WDA was proportionately decreased or increased (*s 310*(*2*)). If an industrial building was acquired with one year of its 25-year tax life remaining, the purchase price (or, if lower, original cost) could effectively attract a 100% allowance.

4.8 However, for transactions on or after 21 March 2007 (but before April 2011, when IBAs were abolished), the purchaser effectively 'inherited' the vendor's claim at tax written-down value (*FA 2007*, *s 36*). From the same date (21 March 2007), the requirement to calculate balancing allowances or charges was abolished (*FA 2007*, *s 36*).

4.9 Where relevant, the residue of expenditure (commonly called the tax written-down value (TWDV)) was generally the original cost, written-down by *net* allowances given, including any balancing allowance or charge on the sale itself – see **12.4** *et seq* for details of calculation. Where a building was sold for more than original cost, all allowances given were clawed back, such that the residue of expenditure was the same as original cost. A second-hand purchaser could never claim allowances on an amount higher than this.

4.10 A practical point is that the clawback of industrial buildings allowances (IBAs) on sale before 21 March 2007 was unavoidable (unless a long lease was granted *in lieu* of an outright sale), whereas a clawback of plant allowances could (and still can) be avoided using a *s 198* or *s199* election (see **4.29**). Taxpayers should, therefore, still attempt to identify and quantify the plant content of industrial buildings.

4.11 Where the expenditure was incurred before 6 November 1962, the duration of the writing-down period was 50 years, rather than 25, and WDAs were at a rate of 2% pa (*Sch 3*, *para 66*).

4.12 Where a claim is being considered for a period in which IBAs are still relevant, it may be worth reviewing the previous use made of the building being acquired. If a building is in industrial use, but industrial buildings allowances are not claimed, notional allowances (see **7.106**) do not have to be written off under *s 336* (CA, para 34700). Therefore, if the vendor failed to claim IBAs because he mistakenly thought the use was non-industrial, the notional allowances should be added back to the residue of expenditure, thereby increasing the amount on which the purchaser may claim plant and machinery allowances.

4.13 A commercial building (eg an office) which qualified for allowances by being constructed in an enterprise zone, was subsequently regarded as an industrial building. Allowances could still, therefore, be available to a subse-

quent purchaser, even after expiry of the enterprise zone (but only until April 2011 – see **7.11**).

PLANT

4.14 When a building is purchased second-hand, the buyer will be acquiring not only a shell building, but also any plant elements contained therein. This will include not only things that are obviously machinery, but also 'integral features' such as air conditioning or heating, and other plant and machinery fixtures.

4.15 It is possible for the purchaser to claim capital allowances on such plant. To the extent that such items are fixtures, they are treated as belonging to the purchaser of the building (*s 181*) (see **11.25**). This also applies where a purchaser of an interest in land pays a capital sum to discharge the obligations of an equipment lessee to whom the fixtures were previously let (*s 182*).

4.16 Usually, such a claim will be based on a 'just and reasonable' apportionment of the total purchase consideration, in accordance with (*s 562*) (which operates by default in the absence of a (*s 198*) joint election – see **4.29** *et seq*). The intention is to apportion the purchase price to reflect the value that each constituent part makes to the value of the whole property (*Salts v Battersby* [1910] 2 KB 155). Any dispute over the apportionment may be resolved by a tax tribunal (*s 563*). In *Wood* (*t/a A Wood & Co*) *v Provan* (*Inspector of Taxes*) (1968) 44 TC 701 (see **Appendix 4**), the Commissioners made an apportionment notwithstanding that fact that a separate price for plant was shown in the purchase contract. However, this decision was made before enactment of the provisions for a *s 198* joint election by purchaser and vendor (see **4.29**).

4.17 In some circumstances, the amount will be restricted to whatever amount is brought into account as disposal proceeds by the vendor (*s 185*). That said, it must nonetheless be emphasised that the matter is not entirely in the hands of the vendor because it is not the vendor's prerogative to unilaterally choose a disposal value (for example, tax written-down value), and the purchaser is not bound to accept the vendor's apportionment, however unfair that may be.

4.18 Furthermore, in the absence of an election under *s 198* (see **4.29**), the Inspector is not bound by any apportionment agreed between the parties and reflected in the purchase contract (*Fitton v Gilders and Heaton* (*Inspector of Taxes*) (1955) 36 TC 233). The question of whether a contract allocation may be ignored by the purchaser is essentially a matter of contract law. All too often, purchasers and their solicitors agree to an allocation of the purchase price, for example for stamp duty/stamp duty land tax (SDLT) purposes (see **22.23** *et*

seq), without any consideration of the impact on capital allowances. Such allocations should be avoided, or it should be made clear they are not to apply for the purposes of capital allowances.

4.19 It is worth noting that HMRC cannot deem the *total* proceeds to be an amount other than the actual proceeds, only the apportionment between different assets can be challenged. In order to show that some assets (eg plant) have been overvalued, HMRC must also demonstrate that other assets have been undervalued (CA, para 12100).

4.20 Expenditure on plant generally attracts a higher rate of allowance than expenditure on buildings (see **Appendix 1**). Prior to 21 March 2007, this position could be reversed where an industrial building was acquired towards the end of its tax life and a balancing adjustment arose (see **4.7**). The existence of long-life assets (see **14.59**) should also not be overlooked.

Restricted claims

4.21 Where the vendor of an interest in land, as defined in *s 175*, has claimed allowances in respect of fixtures attached to that land, he is required to bring into account a disposal value (that is, a negative adjustment to the capital allowances pool in which the expenditure was recorded to reflect the value, or deemed, value, of that plant when disposed of).

4.22 Where, on or after 24 July 1996, a person incurs expenditure on fixtures, in respect of which a former owner has been entitled to allowances, then the maximum amount on which allowances may be claimed will be equal to the disposal value required to be brought into account by that former owner (together with any incidental expenditure under *s 25* – see **14.37** *et seq*).

4.23 If the fixtures are acquired from a taxpayer, the qualifying expenditure will, therefore, be limited to the disposal value brought into account by the vendor, which in turn will be restricted to that vendor's original cost (or cost to a person connected with the vendor, if higher – (*s 64*)). If the fixtures are acquired from a non-taxpayer (for example, an exempt fund) allowances may still be restricted to the disposal value brought into account, not by the vendor (for whom there will be no disposal value) but by an earlier claimant. This will only apply, however, if that earlier claimant disposed of the fixtures on or after 24 July 1996. If, since that date, there has been no disposal by a taxpayer, the claim by the new purchaser will not be restricted and will be based on a just apportionment of the total expenditure under (*s 562*). This restriction does not apply where assets have been severed from the building and sold other than as fixtures (*s 185*).

4.24 Two key points emerge, which the prospective purchaser must not overlook:

(*a*) The capital allowances on fixtures will be of particular value if they have, since 24 July 1996, been continuously owned by a person who was not entitled to allowances (or indeed, a series of such persons).

(*b*) The quantum of any claim may only be properly established with full knowledge of the history of ownership of the relevant fixtures. The intending claimant should, therefore, require such details from the vendor as part of the acquisition process (see **4.5**). In HMRC's view, the onus is on the purchaser to prove the capital allowances history of the assets acquired, in support of which inspectors refer to *West Somerset Railway Plc v Chivers* (*Inspector of Taxes*) [1995] STC (SCD) 1. However, that case does not impose an absolute obligation on the taxpayer, but rather speaks of a 'balance of probabilities' (see Appendix 4).

Different type of allowances previously claimed

4.25 Where the property acquired includes fixtures which have previously been involved in a claim for IBAs or research and development allowances, the qualifying expenditure is restricted to (in the case of IBAs) the portion of the consideration attributable to the fixtures on the assumption that the consideration was equal to the residue of expenditure on the relevant interest, or (for research and development) to the portion of the consideration attributed to the fixtures, limited to original cost (*ss 186* and *187*).

Disposal values: anti-avoidance

4.26 Where, with a view to 'avoidance', a vendor brings into account a disposal value which is less than the notional tax written-down value (TWDV) of the relevant plant, that TWDV is substituted for the actual disposal value. Consequently neither a balancing charge nor a balancing allowance will arise. However, this only applies to the vendor – the purchaser's claim will be restricted to the actual (low) consideration. ('Avoidance' is defined as the obtaining or increase of an allowance or deduction, or the avoidance or reduction of a charge (*s 197*).)

4.27 Furthermore, when after 31 March 2008, an asset is sold, and that asset was one allocated to the 'special rate' pool (for integral features, long-life assets and thermal insulation), anti-avoidance provisions potentially apply. If the asset is disposed of for less than its TWDV, as part of a scheme or arrangement having the obtaining of a tax advantage as a main purpose, then notional TWDV is substituted for the actual disposal value (*FA 2008*, *Sch 26*).

4.28 The disposal value may be below TWDV for genuine commercial reasons, rather than for reasons of tax avoidance, in which case it may not be challenged by HMRC (*s 197*).

Apportionment of consideration: joint election

4.29 In either of the above situations, the parties to a sale may elect to fix the amount to be allocated to fixtures (*s 198*). The amount so allocated may not exceed the original cost of those fixtures. Obviously, if the total sale price is less than the original cost of the fixtures, then the amount apportioned cannot exceed that. The irrevocable election must be made jointly within two years after the date of the relevant transaction, and must include:

(*a*) the names and tax references of both parties;

(*b*) sufficient information to identify both the relevant land (to which the fixtures are attached) and the machinery or plant;

(*c*) details of the interest acquired; and

(*d*) the amount fixed by the election.

(See pro forma election, **Appendix 5.**)

A formal election is the only way to guarantee an agreed apportionment at the outset – it is not sufficient that an apportionment is included in the purchase contract, as such an apportionment is not binding on HMRC (*Fitton v Gilders and Heaton* (*Inspector of Taxes*) (1955) 36 TC 233).

In most practical situations, it will *not* be to the purchaser's advantage to enter into an election, rather than rely on the default 'just apportionment' provisions of *s 562*. Professional advice should be sought whenever a *s 198* election is proposed by the vendor.

4.30 HMRC accepts a single election covering all the fixtures in a single property (but not multiple properties) – HMRC Tax Bulletin 35 (June 1998) and CA, para 26850. In practice, where an amount has been agreed between vendor and purchaser covering several properties, HMRC will accept an apportionment between the properties on a reasonable basis, such as book value or floor area.

On the subject of HMRC accepting an election covering all the fixtures in a property, it is worth looking closer at what the Revenue Manual actually says. CA para 26850 states:

> 'The fixtures rules work on an asset-by-asset basis. In practice, you may accept a degree of amalgamation of assets where this will not

> distort the tax computation. Provided that there are no specific factors which could give rise to distortion, you may accept an election covering all the fixtures in a particular property but not for a portfolio of properties.'

It is unclear what is meant by the term 'distortion'. It is arguable that distortion of 'the tax computation' does take place where the amount allocated to fixtures by an election under *s 198* is clearly insufficient, in that it bears no relation to the amount which has actually been paid for those fixtures, for example where an election for £1 covers assets clearly worth millions.

Distortion may also be relevant where the plant acquired consists of both integral features and other plant, and the election fails to allocate separate amounts to each.

4.31 It must be remembered that an election under *s 198* can only cover plant on which the vendor has claimed allowances. The purchaser may still be able to claim allowances on an 'unrestricted' basis on other items of plant which were not identified as such by the vendor, and are in consequence not covered by the election. It should also be remembered that an election under *s 198* relates only to fixtures, and not to movable plant (that is, chattels). It is also understood that HMRC's view is that a *s 198* election is impossible if the buyer is non-resident and outside the UK tax net. This is because a *s 198* election must give the tax district and reference of each person making the election and persons of this type will not have a tax district and reference, and so cannot make a valid election (CA, para 26850). Presumably, the same may apply if the purchaser is otherwise not within the charge to tax (eg a government body, etc). A Real Estate Investment Trust (REIT), as permitted from 1 January 2007 by *Finance Act* (*FA 2006*), cannot make a *s 198* election on joining or leaving the REIT regime, or on transfer of property across the 'ring fence' to its non tax-exempt activities, but is otherwise able to elect when a property is acquired or disposed of by the company.

Common errors in s 198 elections

4.32 In practice, many elections appear to be technically invalid, for a variety of reasons.

Vendor didn't claim

4.33 It is explicitly stated that the *s 198* legislation applies 'if the disposal value of a fixture is required to be brought into account', which can only be the case if the vendor has claimed allowances on the fixtures concerned (s *64*).

Some *s 198* elections purport to be made in cases where the vendor has not claimed allowances (for example, a developer, holding the property as trading stock, and therefore clearly not eligible for capital allowances).

Missing information

4.34 *Section 201* sets out certain information which a *s 198* election *must* contain, including:

(*a*) the amount fixed by the election;

(*b*) the name of each party to the election;

(*c*) information sufficient to identify the plant or machinery;

(*d*) information sufficient to identify the relevant land;

(*e*) particulars of the interest being acquired (and the date of the transaction); and

(*f*) the tax district references of each party to the election.

Some of this information is often omitted, with the result that the election may be arguably invalid. For example, an inspector would seem to be within his rights, if he rejected an election which failed to give the tax reference numbers of each party.

Identifying the fixtures

4.35 The requirement presenting the greatest practical difficulty appears to be the obligation for "information sufficient to identify the plant or machinery". In a great many cases, the lack of detail could arguably invalidate the whole election. The following are the problems most commonly seen.

4.36 Firstly, many elections refer simply to 'all the fixtures at the property', 'all fixed plant and machinery', or equivalent wording. There must be serious doubt whether this is sufficient to identify the plant or machinery which is purportedly subject to the election.

4.37 Secondly, some elections merely refer to a standard list of fixtures which may be typically found in a building (normally with no values against any of the descriptions), but which may or may not be present in the actual property which is the subject of the election. Again, this is insufficient to identify the plant or machinery which is purportedly subject to the election. For examples, some elections have listed a lift among the items of plant, when no lift actually existed.

4.38 Thirdly, some elections in effect combine (a) and (b) by referring to 'all the fixtures at the property, including but not limited to' the assets shown on an attached standard list. It is difficult to see how such terminology can be consistent with the legislation.

4.39 Fourthly, some elections refer to an inventory of fixtures and fittings, which typically includes both fixtures and chattels. *Section 198* can only relate to fixtures. Therefore, if an election purports to relate to fixtures and chattels (with no separate amounts allocated), the entire election would appear to be invalid. This is because the legislation states that the amount fixed by an election must be quantified at the time the election is made. Where the amount allocated to the fixtures (rather than the chattels) is not clear, the amount cannot be said to be fixed.

4.40 Fifthly, when elections refer to 'all fixtures at a property', they often do so without considering whether or not the fixtures concerned have been subject to a claim. Frequently, allowances will only have been claimed on some of the fixtures, in which case, the election is partly invalid, to the extent that it relates to assets which have not been subject to a claim, and for which no disposal value is therefore required to be brought into account.

4.41 Sixthly, the election sometimes claims to cover assets that appear to be ineligible (broadly, assets which are not accepted as plant), in which case it is clearly invalid. If an election purports to relate to both eligible assets and ineligible assets (with no separate amounts allocated), the entire election would again appear to be invalid, as the amount fixed by the election (for qualifying assets) has not been quantified at the time the election is made.

Quantifying expenditure on plant

4.42 If the qualifying expenditure is to be calculated on a full apportionment basis, there will be a good deal of work necessary to maximise the claim. The process of establishing the amount qualifying for plant will consist broadly of the following steps:

(*a*) Land valuation;

(i) No allowances are due in respect of the purchase of land. The first task, therefore, is to establish the value of the land (the so-called 'bare site value'). Any land valuation must be referred by the Inspector to the District Valuer (CA, para 12300).

(ii) The District Valuer will also advise the Inspector, if requested, on the question of apportioning building expenditure between qualifying and non-qualifying (see **1.46** *et seq*).

(*b*) Building and plant valuation;

(i) Having determined the value of the land, the taxpayer then needs to split the balance of the purchase consideration between buildings and plant.

(ii) It is not always necessary to try to estimate those relative values as at the date of the purchase. Bear in mind that the purpose of this exercise is merely to establish the relative proportions of buildings and plant so that those percentages may then be applied to the purchase consideration.

(iii) The easiest route to take is, therefore, to value plant and building as at the current time. It is essential to compare like with like. Both elements should, therefore, be valued according to their current replacement value. It is commonly thought that the plant (and not the building) should be depreciated. This is, however, neither logical nor correct. Any depreciation is, in effect, reflected in the purchase price, which is then reflected in the apportioned values of the elements of the property. However, when a building is near the end of its life the purchase price may reflect substantial redevelopment value. In such circumstances the building's obsolescence may not be fully reflected in the purchase price and it may sometimes then be necessary to adjust the replacement costs to allow for obsolescence

(iv) When inspecting a property for the purpose of identifying plant, the taxpayer and his advisers must be aware of the respective interests, ie who has paid for what. For instance, it may be that the freeholder now selling his interest was responsible only for the shell building, and that all fitting out was funded by tenants. In this case, the allowances on fittings will remain with the tenants.

(v) For transactions on or after 1 April 2008, it is also necessary to attribute separate values to 'integral features' (see **14.3**) and other plant.

Apportionment formulae

4.43 The method of apportioning costs to determine qualifying expenditure is not prescribed by statute. It is, therefore, a matter for negotiation between the taxpayer, his advisers and HMRC. In accordance with the decision in *Salts v Battersby* [1910] 2 KB 155, the underlying aim of any method of apportionment should be to apportion the purchase price in proportion to the values of the constituent parts that go to make up the property. Simply deducting a value for the land is not sufficient (*Enterprise Zone Syndicate v Inspector of Taxes* [1996] STC (SCD) 336).

4.43 *Purchase of a second-hand building*

Set out below are just two of the possibilities when quantifying, say, the plant content of an office building. The Valuation Office Agency (VOA) has expressed a preference for the following formula, which is almost always used in practice (VOA manual, para 3.31):

Q = P x A B + C

Where Q = qualifying expenditure

A = the replacement cost of the qualifying assets

B = the replacement cost of the building (including plant content)

C = the land value (ie bare site value)

P = purchase consideration

As mentioned above, the VOA formula is not mandatory. A common alternative (using the same notation) is:

Q = (P – C) x AB

Although the two formulae above are not mandatory, in practice, the VOA will almost always insist on the first formula and is normally extremely reluctant to accept different apportionment methods, unless there are very strong grounds for doing so. One area where the VOA does sometimes seek to depart from use of the formulae is where fixtures and chattels are acquired together. In such instances, it is not uncommon for the VOA to argue that because the chattels are not fixed to, and part of, the building they should not be valued with it, but should instead be valued separately (for example, based on their individual second-hand market values). Nonetheless, the chattels must still form part of the overall apportionment under *s 562*.

The apportionment formula can have a significant impact on the value of a claim.

Example

Snowden Ltd acquired an office building for £40 million in such circumstances that any expenditure qualifying for allowances was to be determined by a just apportionment under *s 562*. Its accountants later obtain estimates of the market/replacement values of the various components as follows:

land	£5 million (C)
building	£50 million (B)
plant therein	£20 million (A)

The two formulae give the following qualifying expenditure. Valuation Office formula:

$$\text{Qualifying expenditure} = £40 \text{ million} \times 20\ 50 + 5 = 14.5 \text{ million}$$

Alternative formula:

$$\text{Qualifying expenditure} = (40 - 5) \times 20\ 50 = 14 \text{ million}$$

In this example, therefore, a mathematical detail can cost (at current tax rates) £140,000 in additional tax. With different figures, however, the result could be reversed, with the alternative formula giving the better result.

4.44 The VOA Manuals include a number of helpful instructions affecting the method of apportionment. They confirm (para 3.31) that plant ('A' in the formula) does not need to be written down due to its age, as age and obsolescence will be reflected in the purchase price. An exception is that if the purchase price is based 'largely or wholly' on the value of the land then the obsolete nature of the building will not be reflected in that price and it may be necessary to adjust the replacement costs for obsolescence (para 3.35).

4.45 The bare site ('C') should be taken as the open market value of the actual site at the date of purchase valued on the assumption that: (i) any reclamation works which have been carried out on the site which permanently enhance the value of the land should be included (eg removing underground obstructions or treating contamination); (ii) the valuation reflects the circumstances existing at the valuation date; and (iii) the interest valued will be the interest actually acquired (eg if a long leasehold, taking account of ground rent). Presumably, where appropriate the assumptions will also still include the following factors listed in a previous version of the manual; (iv) the site is cleared of all building and external works; (v) access and services are available up to the boundary; and (vi) planning permission is available for the existing type of development (para 3.33).

4.46 The replacement costs used in the formula ('A' and 'B') should be taken as the estimated cost of replacing the building if work had commenced at the appropriate time as to have the building available for occupation at the date of purchase. It should include: (i) site works, but not any reclamation works which permanently enhance the value of the bare land; (ii) the cost of external works; (iii) professional fees; and (iv) finance charges (para 3.66). The last-

mentioned is often ignored in practice, as finance charges do not generally qualify for capital allowances, following *Ben-Odeco Ltd v Powlson* (*Inspector of Taxes*) (1978) 52 TC 459. If, due to the use of modern materials and building techniques, the cost of erecting a modern substitute would be less than the cost of an identical replacement building, the cost of the modern substitute should be used (para 3.66). Informally, however, the VOA has sought to disapply this rule where the property is listed, or where the old-fashioned materials were prestigious, even at the original time of construction. No deduction should be made for any Regional Development Grants that may be available (para 3.66).

Practical considerations

4.47 Where a claim for allowances is to be restricted, the requirements of the vendor and of the purchaser may be in direct opposition (but not where the vendor has not made a claim, as is often the case).

Example

A Ltd purchased an office building on 1 July 1994 for £750,000. The following year it spent £200,000 on the addition of an air-conditioning system and claimed capital allowances.

In 2004, A Ltd agreed to sell the building to B Ltd for a total consideration of £2 million. The one matter outstanding was the amount to be apportioned to the air-conditioning. B Ltd would want as high an amount as possible allocated to the plant to maximise its capital allowances claim. A Ltd, however, wants to bring into its pool a low disposal value if indeed it has to introduce one at all.

4.48 In other cases, it may be that the position of, say, the vendor is slightly different. If, in our example, A Ltd had been steadily making losses then its own capital allowances position is of little concern. There may, in fact, be scope for A Ltd to permit a very high allocation to plant in exchange for a slightly larger selling price.

4.49 The optimum allocation is thus not always achieved, and should not be taken for granted by either party. If the vendor and the purchaser can reach agreement, the inclusion of an allocation of expenditure in the documentation, though not binding on HMRC, should avoid any later dispute between the parties themselves. Inclusion of the agreed allocation in an election under *s 198* (see **4.29**) will be binding on HMRC.

4.50 If the vendor wishes to continue to claim capital allowances, this can be achieved by including in the sale contract (or a *s 198* election) the lowest

sustainable valuation of the plant. As plant is generally pooled for capital allowances purposes, the effect is that allowances will continue to accrue to the vendor almost indefinitely.

4.51 Of course, it must always be borne in mind that the tax tail should not be allowed to wag the commercial dog. It is undoubtedly simpler (at least in the first instance) to ignore capital allowances altogether. In practical terms, there is some justification for ignoring the capital allowances position only where the amounts involved are known to be insignificant.

4.52 Both parties should beware of ignoring capital allowances simply for an easy life; such a move may cost more in terms of both time and money in the long run. At an early stage, a 'desk top review' should be undertaken in order to establish entitlement and to be sure that the likely savings from capital allowances exceed the cost of putting the claim together. The purchaser should make standard enquiries of the vendor, using the form CPSE1 or equivalent.

If necessary, appropriate clauses should be included in the purchase contract. The reasons for taking such action at this stage are threefold:

(i) The vendor will be put on notice that he has certain obligations to fulfil and information to provide.

(ii) If appropriate, the relevant clauses may be 'traded' against others onerous to the purchaser.

(iii) If such thoughts are only raised when the contract is on the verge of completion, such technical details may be sacrificed in order to 'clinch the deal'.

4.53 The vendor may, of course, have requirements of his own regarding capital allowances. He may, for example, be seeking a relatively low apportionment of the consideration to plant so as to mitigate any balancing charge. The final agreement is a matter for negotiation. A vendor may often argue for a contract allocation (or a *s 198* amount) equal to tax written-down value on the grounds of 'fairness'. Such fairness is, however, an illusion where (as is generally the case) a property is sold at a profit. Consider the following example:

Example

Albert buys a building for £1 million and claims allowances on fixtures of £250,000. After three years (when the fixtures are written down to £128,000; for simplicity assuming 20% writing down allowances) he sells the building to Bertram for £1.2m. In the absence of a *s 198* election, the amount apportioned to

fixtures could reasonably be expected to be around £300,000, but as Albert made a claim, the amount would be restricted to the original cost of £250,000. A *s 198* election for £128,000 would allow Albert to keep allowances (intended, do not forget, to compensate for a fall in value) of £122,000 relating to assets on which he has in fact made a gain.

DOCUMENTATION

4.54 Using the typical scenario of the purchase of a second-hand office building, inclusive of an unquantified plant content, this section considers what documentation should be put in place.

4.55 The requirements of the purchaser and the vendor are often mirror images of the same problem. For clarity, the requirements below have been considered from the point of view of the purchaser. Not all the items mentioned will be appropriate in every case. It is often better, however, to begin with many demands, which can if appropriate be 'traded' in the course of the purchase negotiations.

- Ideally, a full inventory should be taken of all potential plant included within the building and being sold. There are specialist firms who undertake such work, not always for capital allowances purposes. This is, of course, an extra cost, but the inventory compiler's independence will be an advantage in the purchase negotiations and perhaps in later dealings with HMRC. If it is not possible to have a detailed inventory, the contract should at least set out the part of the purchase price attributable to the total plant element.
- The purchaser should seek to obtain confirmation from the vendor that the value attributed to each item is less than the 'ceiling' imposed by *s 185* (see **4.22** *et seq*), which in most cases will be the original acquisition cost to the vendor.
- The vendor should also state which of the items listed on the inventory have been accepted as plant by HMRC, and whether any have been treated as long-life assets (see **14.67**). Whether the assets continue to be treated as plant will depend on the purchaser's use of them.
- In the context of the fixtures legislation, the qualifying expenditure of the purchaser may be restricted by the disposal value brought into account by the vendor (see **4.21** *et seq*). The purchaser should seek, therefore, to at least be kept informed of the vendor's negotiations with HMRC in respect of the relevant plant. If the figures are material, the purchaser may even wish to review the correspondence in draft.

- The purchaser should seek to incorporate in the purchase documentation a statement that the vendor will make available all relevant information to the purchaser, and will provide him with all reasonable assistance for the preparation of his capital allowances claim. The purchaser may also require an undertaking from the vendor that he will sign any appropriate elections, for example in connection with the transfer of allowances under *s 290* (see **11.6** *et seq*).
- The parties may also wish to incorporate in the contract a statement that an election under *s 198* will be entered into, at the request of either party (see **4.29** *et seq*). However, although it theoretically avoids the need to prepare an apportionment, entering into a *s 198* election is generally inadvisable for a purchaser, because the amount is likely be much less than the *s 562* apportionment that would otherwise apply by default.
- In some cases, the purchaser may try to obtain an indemnity from the vendor regarding the right to capital allowances. That is to say, a failure to obtain allowances would result in the purchaser being reimbursed by the vendor. This is commonly the situation where a landlord constructs a building to his tenants' requirements and the rent payable varies with the success or otherwise of the landlord's capital allowances claim.

4.56 Where an industrial building is being purchased, the following will also be relevant.

- Evidence of the date on which the building was first brought into use, and/or on which additional expenditure on the building was incurred. For expenditure incurred after 5 November 1962, allowances are given over a period of 25 years, prior to that date, over a period of 50 years (see **4.7**).
- Confirmation of the amount on which the vendor has successfully been claiming allowances and details of the residue of expenditure (that is, TWDV) after the sale (see **4.7** *et seq*). This will impact on the purchaser's qualifying expenditure in that in most cases his claim will be based on the lower of the amount he pays, and the amount paid by the vendor.
- Details of use of the building by lessees or licensees and confirmation that the lease agreements oblige the tenants to use the building only for purposes qualifying for IBAs.

4.57 Where contaminated land is acquired, or where, for example, asbestos is present, the purchaser should retain all environmental reports. Note, however, that if the purchase price is reduced because of the contamination, land remediation relief (see **Chapter 24**) may be denied. This is generally no more than a hypothetical risk.