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Tax allowances on property

There is no point in paying more tax than you have to. Some of your property-related spending may be allowable against your profits for tax; but this depends on the classification of the expenditure – a highly complex area where you really need the specialist advice of your chartered surveyor and accountant at the earliest possible stage.

What are capital allowances?

Capital allowances are a tax relief designed to allow the cost of certain of your company's assets to be written off against taxable profits. If you buy an asset for use in your business you may be able to claim a capital allowance for that expenditure.

Capital allowances are available to sole traders, self-employed people or partnerships, as well as companies and organisations liable for Corporation Tax.

How many types of allowances are there?

The most common type of capital allowance is for plant and machinery (P&M), but for many businesses this is only one of the types of capital allowances that can be claimed. The others are:

- business premises renovation allowance (BPRA)
- enhanced capital allowances (ECA)
- mineral extraction allowance
- research and development allowances (RDA, previously known as SRA – scientific research allowances)
- know how
- patents
- dredging
- assured tenancies.

What qualifies for allowances?

Capital allowances are complex and not always very logical. However, shops, offices, leisure facilities, care homes, factories, airports and countless other types of buildings often contain large amounts of plant and machinery that qualify for capital allowances. This value will represent a significant proportion of the cost of the property as a whole. Some examples of items that can be plant include air-conditioning systems, lifts, IT/data cabling, sanitary appliances, alarm and security installations, some floor finishes, moveable or demountable partitioning systems and electrical installations.

In all cases, expenditure on the provision of plant and machinery does not include expenditure on land. Also, with very few exceptions, expenditure on the setting or premises are not allowable either. In case law, building, premises and setting are all terms which mean the building fabric. Chapter 3, sections 21 to 25 of the Capital Allowances Act (CAA 2001) set out what parts of buildings and structures can and cannot be plant.

The table below shows the rate of capital allowance for different classes of property/asset. In other words, the annual amount of eligible expenditure you may offset against your profits, before applying your tax rate. Over time, the total cost of the allowances identified on the asset should be recoverable via these tax allowances.

Type of property or asset	Rate of annual allowance %	Notes
Plant and machinery – main pool	18	Includes various items of plant and equipment in commercial buildings (see text), but excludes anything that is defined as integral features or new assets that are classified by legislation as long-life
Plant and machinery – special rate pool, including long-life assets	8	For integral features plant and machinery* and other items with an economic life, when new, of 25 years or more
Energy-efficient plant that qualifies for enhanced capital allowances (ECAs)	100	Energy-efficient plant and machinery meeting legislative criteria. Includes combined heat and power, motors, boilers, lighting, insulation, etc. See **decc.gov.uk**
*	**Integral features** are listed at CAA 2001, Section 33A. They are: • electrical systems • cold water systems • heating, ventilation and air-conditioning installations • lifts, escalators and moving walkways • external solar shading.	

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How is property expenditure classified?

Broadly, between 'revenue expenditure' and 'capital expenditure'. Revenue expenditure may be charged against your income before arriving at the profits that are subject to tax. Capital expenditure is spending on items that remain on the balance sheet beyond the year-end as an asset of the business.

Though these assets will be depreciated in your accounts, this depreciation is not allowable against profits for tax purposes. Instead of this you may charge against income a 'capital allowance' in respect of money you have spent on certain classes of asset. Unfortunately, only certain categories of property qualify for a capital allowance.

What qualifies as revenue expenditure?

Revenue expenditure would cover your spending on 'consumable' items that will have no value after the year-end, such as rent, insurance, building repairs, salaries, stationery and the like. The definition of 'repairs' may be complex and you need professional advice here.

What qualifies as capital expenditure?

In general terms, capital expenditure is spending associated with the creation or acquisition of an enduring asset, typically covering semi-permanent or permanent items that will have a value beyond the end of the financial year. Examples of capital expenditure include your spending on buying a property, on a new shop front, on a new computer system, new heating equipment, new manufacturing equipment, etc.

Where is the dividing line between capital and revenue spending?

This is an area that has caused difficulty for taxpayers and HMRC for many years, as the division is not always clear cut and can vary from project to project. If the whole of a property is new there is very little doubt that all of the costs should be capitalised. However, if you extend an existing building and the original building is in need of some maintenance, which you, for convenience sake, roll into your new extension project, the divide becomes less clear. Any works done to renew anything on the original building in its entirety (the whole roof for example) will be classed as capital. If, on the other hand, you do a patch repair to the roof or replace one or two windows, this cost can be treated as a revenue expense (this is sometimes referred to as revenue within capital).

You need to look at the works you are doing in these situations and decide how the expenditure would have been classified if you had done the work as two separate projects. Generally, any replacement of a whole asset, such as an entire roof, will be regarded as creating a new asset. Any replacements that involve an element of upgraded specification, for example double glazing to triple glazing, would not be classed as a repair.

Repairs would normally be a revenue expense. However, if you buy or rent a dilapidated building at a price which reflects the state in which you acquired it and the fact that money will need to be spent to bring it up to a useable standard, the cost of the works, even though they are of a repairing nature, may be classified as capital. You will only be able to get a tax deduction for this work to the extent that any of it qualifies for capital allowances.

Be assured that you cannot have it both ways. Increasingly, HMRC requires your tax accounting and your published accounts to follow the same lines (except in the case of depreciation!). So if you capitalise an item in your accounts but claim it as a revenue deduction in your tax calculations you cannot be sure of getting 100% tax relief against your profits and you may have to add it back and claim capital allowances, where appropriate.

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How do you make a claim for allowances?

No capital allowances will be given unless you make a claim for them in a tax return. Because of the system of writing down allowances, over time the total cost of the asset is recoverable. Generally, the bulk of the allowances are given in the first eight to 10 years.

When speaking of 'preparing a claim' it is assumed that it is clear what does and what does not qualify as a claimable asset and all that needs to be done is to list these out. In reality it is much more complex. As legislation, case law and even building techniques have moved on, the number of areas that are not really clear has grown too and so applying the rules to the facts is not as easy as it may have once been.

Making a capital allowances claim requires a lot of planning, research, legal argument and clear presentation. Due to the complexity a key consideration is whether the amount of work required can be justified in relation to the cost of the exercise and the eventual value of any claim.

Take professional advice to be clear about what could be possible and make an informed decision on whether or not to proceed.

Can I plan ahead to minimise tax?

Yes. Before embarking on any major expenditure, you should understand and plan its revenue and capital allowance consequences. So call in your property tax adviser (chartered surveyor and/or accountant) at this point, not when the work is already under way. It is a good idea to take notes and photographs of the condition of the building before repairs or improvements are carried out and to record the reason for the work. These may help 'prove' subsequently to your inspector of taxes that the expenditure should be tax deductible. Capital allowances may also be obtained retrospectively on earlier expenditure, so there may be opportunity to lodge significant new claims or review and improve previous claims where you still own the assets.

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