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For the attention of Hasmukh Haria

24 August 2011

Dear Sirs

Revenue Law Committee response to Consultation Document on Capital Allowances for Fixtures

The City of London Law Society ("CLLS") represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of the consultation document on capital allowances for fixtures has been prepared by the CLLS Revenue Law Committee.

General comments

We would agree with the Government's view as expressed in the consultation document that the requirement introduced in 1996 to look back at all previous fixtures allowances claims in determining a new buyer's maximum allowable expenditure has, over time, led to significant evidential problems.

We are however unconvinced that these problems require a policy response on the scale contemplated. In particular, if the burden of proof of the history was clearly and unambiguously placed on the taxpayer (as is arguably the case at the moment in any event), we believe that the issues of "late claims" which are addressed by the proposal for mandatory pooling could be fully addressed. We would note that where a building

has been held by a tax exempt entity which does not claim allowances, even the mandatory pooling approach will not greatly assist HMRC in resisting a taxpayer who asserts that there has been no previous allowances claim in respect of fixtures such as would limit its own claims going forward, as any previous claim may be so long ago that all the problems identified in the consultation document would still arise.

We would also note that the question of whether a given asset is or is not a fixture is often an extremely difficult one. If a progressively more restrictive regime is introduced for fixtures as against loose plant and machinery, it is likely to lead to more extensive (and hence resource-consuming for both HMRC and taxpayers) debates about whether particular assets are or are not fixtures. This has frequently proved a difficult issue in other cases (most notably stamp duty land tax, where historically, for instance, until practice was relaxed, it was common for machinery to be unbolted from its mountings for a few minutes while contracts were signed). To date this has not been too much of an issue in the context of allowances.

Finally, we would note the recent report of the Oxford University Centre for Business Taxation which concluded that the UK had the least competitive regime for depreciation relief in the G20, and that looked at in the round this was acting as a significant counterbalance to the competitive benefits achieved by the reductions in the headline rate of corporation tax. Given the Government's stated aim to have the most competitive corporate tax system in the G20, we would suggest that further restrictions to the capital allowances regime should be approached with extreme caution.

Responses to the specific questions set out in the document

Q1: Which time limit for mandatory pooling would be better: one year or two years after the property acquisition?

We do not as a matter of principle have a strong view on this question, if the mandatory pooling proposal is to go ahead (as noted in the general comments above, we consider that the issues it is designed to address would be better dealt with by way of adjusting the burden of proof as to previous allowances claims).

If mandatory pooling is nonetheless to be required, we would generally favour a longer period as the ability to defer pooling is a well-established feature of our allowances system, and we would favour maintaining the internal consistency of the system to the greatest possible degree. So on the basis that we believe that the rules relating to fixtures should be as similar to the wider regime as possible, we would favour the longer period. We also suspect that the one year period will in practice be unachievable, given the deadlines for tax filings more generally. If a corporate taxpayer has a calendar year accounting period and acquires a property on 2 January 2012, it will not be liable to submit a tax return until 31 December 2013, almost two years later, so any time limit of less than two years is not consistent with the suggestion that taxpayers would notify HMRC of pooling through existing self assessment processes.

Q2: What issues would arise from a requirement to pool historic expenditure on fixtures, and how might these affect what time limit could be set for pooling such expenditure?

The key issue here is the extent to which taxpayers may be considered to have legitimate expectations that the tax regime as applied to assets they already own will be unchanged until disposal. In this context we do not believe that much weight could be attached to this.

We suspect that the greatest impact of this change, if introduced, will be a very large increase in allowances claims when the deadline is reached. This is likely to strain HMRC's resources, especially as many of these may relate to assets where any allowances claim by a previous owner was some time ago, leading to the issues the consultation document is attempting to address.

Q3: What impacts (if any) – perhaps particularly on small businesses or on the property sector – would you expect to arise from the proposed new pooling requirement?

We do not expect the impact of the proposed change to be significant.

Q4: Do you have any views on the assumptions or analysis in the initial Taxes Impact Assessment at Chapter 4, or any relevant data on potential impacts that would improve this assessment?

No.

Q5: Do you think that the proposal that capital allowances should be conditional on a notice of agreement would improve the clarity and working of the fixtures rules?

Very definitely not. Assuming that s.198 elections are to be retained in some shape or form (as to which see our comments below), we do not see that a notice of agreement will achieve anything for either taxpayers or HMRC other than an additional administrative burden.

Taxpayers who are well advised enough to be aware of the consideration apportionment issues around capital allowances will almost invariably enter into s.198 elections. Once such an election is entered into, the market value of the fixtures in question becomes irrelevant for tax purposes. Taxpayers who are not aware of the issue will presumably not produce notices of agreement.

Q6: What comments do you have on the administrative implications, and do you have any suggestions for improving the proposal?

The administrative implications will be considerable, and as noted above we do not see that any benefit is achieved for either HMRC or taxpayers.

When buildings are sold, the parties to the transaction price the buildings. They do not separately price the fixtures. A requirement to produce a proper assessment of the market value of the fixtures would be extremely burdensome and impose extra transaction costs – it would, for instance, presumably require the involvement of a professional valuer. And yet, as long as s.198 elections will remain, the result is likely to be irrelevant to the tax treatment of the parties.

We understand the attraction to HMRC of requiring a document to be produced on every property transaction apportioning consideration to fixtures. However our view is that this result would be far better achieved by making the entry into s.198 elections mandatory. This would be a far less burdensome result than requiring an assessment of the market value of the fixtures, since the price fixed would then simply be the outcome of a negotiation between the parties having regard to each others' tax positions.

If no such mandatory election was entered into, we would suggest that the seller be deemed to have sold the fixtures for their tax written down value, and the buyer be

deemed to have acquired them for nil consideration, such that the allowances are extinguished.

This approach would require some amendment to the existing rules on s.198 elections such that they could be made in relation to transactions where the seller is not required to bring in a disposal value. We do not see that this should be difficult from a policy perspective where an owner prior to the immediate seller has brought in a disposal value which would operate to restrict the claim.

We can see that there would be an issue in relation to fixtures installed by an immediate seller which is not required to bring in a disposal value (as HMRC would need to ensure that an unrealistically high value could not be attached to fixtures in a transaction where the seller had no incentive to drive the value down). In such a case we would suggest that the value attributed to fixtures in the s.198 election could not exceed market value. In these circumstances, effectively requiring a market value assessment to be undertaken would not result in an additional administrative burden since this would merely replicate the exercise a buyer from a seller who cannot make a s.198 election goes through now.

Q7: Do you think that such a record should follow a general format similar to that at s.201 CAA 2001, or take some other form?

See above. We believe that the problem should be tackled using the existing s.198 election regime rather than by creating an additional documentary requirement.

Q8: What issues would these suggestions [relating to s.198 elections] raise for business, and what impacts would either/both have?

We would initially make the point that what is proposed here in relation to s.198 elections is a very material policy change. We would question the assertion in paragraph 1.13 of the consultation document that the legislation is not delivering its policy intentions in allowing sellers to retain the benefit of allowances by electing for a nominal disposal value. We would suggest that at the time the ability to elect was introduced, this possibility was fully recognised but the additional certainty offered by the election process for both HMRC and for business was felt to outweigh any loss to the Exchequer as a result of this effect.

We would submit that this is still the case. Whilst we would acknowledge that the reduced rates of allowances introduced since 1996 will mean that the benefit of accelerating allowances on sale is increased, on the flipside the reduced rates of corporation tax have the opposite effect. Overall we expect the Exchequer cost is little changed from when the regime was last actively considered. Meanwhile, s.198 elections have proved enormously valuable in practice, precisely because they enable parties to transact with certainty as to the capital allowances position. They also greatly reduce the need for HMRC to get involved in time-consuming valuation arguments, which, as we note below, would typically be conducted with two different taxpayers with divergent interests.

The proposed change limiting the minimum value for s.198 election purposes to tax written down value will in many cases introduce real uncertainty for parties in place of the existing simple and certain position. This is because it is wrong to assume that the tax written down value of fixtures will necessarily be known at the time a building is sold.

Where fixtures have been installed by a seller, it is not uncommon for the allowable expenditure not to have been agreed with HMRC at the time a building is sold. Limiting

s.198 elections by reference to tax written down value will therefore remove the crucial element of certainty in such cases. Where there is debate, and the parties wish to elect for tax written down value, it will force the tax computations of two different taxpayers to be held open pending resolution. In turn, this will lead to an increase in transaction complexity as the two parties will need to agree a contractual framework for their dealings with HMRC in resolving the issue (in which they will typically have diametrically opposing interests, as the seller will be incentivised to push for the maximum historic amount of allowances whereas the buyer will be incentivised to push for the opposite result).

We would therefore urge that the existing rules relating to s.198 elections are retained. Whilst there is clearly some loss to the Exchequer as a result of the ability to elect for a nominal disposal value, our very strong view is that, as was the case when the ability to elect was first enacted, this loss is more than outweighed by the simplicity and certainty delivered to both taxpayers and HMRC.

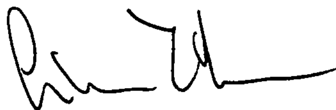
Q9: Do you have any suggestions for alternative proposals that would be more effective in delivering the underlying policy purposes?

See above. We do not feel strongly about the mandatory pooling requirement, though we feel that the issue could be better dealt with by making explicit that the burden of proof as to the historic allowances position falls on the taxpayer.

We feel that the proposal to require a notice of agreement as to the market value of fixtures would be of negligible benefit to HMRC whilst imposing significant extra administrative burdens and costs on taxpayers, and should be dropped.

In place of the notice of agreement we would suggest that s.198 elections be made mandatory, subject to a cap of market value where the seller is not required to bring into account a disposal value. The ability to elect at any value from £1 to maximum disposal value should be preserved as the certainty it brings is of enormous value. Furthermore, the introduction of mandatory s.198 elections in all cases would greatly assist the evidential question and so potentially render the changes to the mandatory pooling regime unnecessary – if a taxpayer seeking to claim allowances on a fixture cannot show it has installed the fixture itself and cannot produce a s.198 election from their acquisition of it, then they cannot claim allowances. We feel that this reform could stand alone to address the concerns raised in the consultation document, and would have the considerable virtue of simplicity.

Yours faithfully,



Simon Yates
Co-Chair
City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

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