These notes refer to the Capital Allowances Act 2001
(c.2) which received Royal Assent on 22nd March 2001

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

1. These explanatory notes relate to the Capital Allowances Act 2001 which received Royal Assent on 22nd March 2001. They have been prepared by the Tax Law Rewrite Project at the Inland Revenue in order to assist readers of this Act and to help inform debate on it. They do not form part of the Act and have not been endorsed by Parliament.

2. The notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So if a section or part of a section does not seem to require explanation or comment, none is given.

SUMMARY

3. The main purpose of the Capital Allowances Act is to rewrite tax legislation relating to capital allowances so as to make it clearer and easier to use.

4. The Act also makes some minor changes to the legislation. These are within the remit given to the Tax Law Rewrite Project and the Parliamentary process for the Bills it produces.

BACKGROUND

The Tax Law Rewrite Project

5. In December 1995 the Inland Revenue presented a report to Parliament on the scope for simplifying the UK tax system (*The Path to Tax Simplification*). The main recommendation was that UK direct tax legislation should be rewritten in clearer, simpler language.

6. This recommendation was warmly welcomed, both in Parliament and in the tax community. After further work on important practical issues and a period of

   preliminary consultation, the then Chancellor of the Exchequer (the Rt Hon Kenneth Clarke MP, QC) announced in his November 1996 Budget statement that the Inland Revenue would propose detailed arrangements for a major project to rewrite direct tax legislation in plainer language.

7. The project team was given the task of rewriting almost all of the United Kingdom's existing primary direct tax legislation, totalling over 6,000 pages. The aim is that the rewritten legislation should use simpler language and structure than previous tax legislation. The members of the project are from different backgrounds, including Inland Revenue employees, private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Parliamentary Counsel Office.

Steering Committee

8. The work of the project is overseen by a Steering Committee, chaired by Lord Howe of Aberavon CH, QC. The membership of the Steering Committee as at December 2000 is in full:

The Rt Hon The Lord Howe of Aberavon CH, QC

Ian Barlow

Adam Broke

Ian Hay Davison

David Hartnett

The Rt Hon Michael Jack MP

Dr John Avery Jones CBE

Professor Frank Kidd

Ms Sheila McKechnie OBE

Dr John Marek MP

The Rt Hon Lord Mustill of Pateley Bridge

David Swaine

Consultative Committee

9. The work is also reviewed by a Consultative Committee, representing the accountancy and legal professions and the interests of taxpayers. Its members as at December 2000 were:

Neil Munro	Tax Law Rewrite Project Director (Chair)
Graham Aaronson QC	Revenue Bar Association
Richard Baron	Institute of Directors
Adam Broke	Special Committee of Tax Law Consultative Bodies
Colin Campbell	Confederation of British Industry
Russell Chaplin	London Chamber of Commerce
Keith Daniels	Chartered Institute of Taxation
Colin Davis	Chartered Institute of Taxation
Malcolm Gammie	Law Society of England and Wales
Terry Hopes	Institute of Chartered Accountants in England and Wales
Matt McGrath	Association of British Insurers
Simon McKie	Institute of Chartered Accountants in England and Wales
Simon Mackintosh	Law Society of Scotland
H C D Rankin	Institute of Chartered Accountants of Scotland
Mavis Sargent	Association of Chartered Certified Accountants
Simon Sweetman	Federation of Small Businesses

Jane Vass	Consumers' Association
Professor David Williams	
Mervyn Woods	Confederation of British Industry

Consultation

10. The work produced by the project has also been subject to public consultation. This has allowed all interested parties an opportunity to comment on draft sections. This consultation is undertaken first through a series of Exposure Drafts which publish sections in draft. The relevant ones for this Act are numbers 3, 5, 7 and 9. They were published in October 1998, April 1999, July 1999 and February 2000 respectively. A draft Act was published for a further consultation in August 2000. Those who responded to one or more of these documents include:

Alliance & Leicester plc

Association of British Insurers

Canary Wharf Ltd

Brian Chapman

Chartered Institute of Taxation

City of London Law Society

Confederation of British Industry

Construction Industry Joint Taxation Committee

Consumers' Association

Ernst & Young

Federation of Small Businesses

Daron H Gunson

Holborn Law Society

Institute of Chartered Accountants in England and Wales

Institute of Chartered Accountants of Scotland

Institute of Directors

Institute of Payroll and Pensions Management

Investment and Tax Publishing Services

John Jeffrey-Cook

KPMG

Law Society of England and Wales

London Society of Chartered Accountants

National Farmers Union

Oil Taxation Action Committee

Special Committee of Tax Law Consultative Bodies

United Kingdom Oil Industry Tax Committee

Yorkshire Water plc

Note: this table excludes those who asked that their responses be treated in confidence.

Capital allowances

11. In general taxpayers cannot deduct capital expenditure in arriving at their income or profits. Depreciation in commercial accounts is not allowed as a deduction for tax purposes. Capital allowances, broadly speaking, take the place of depreciation charged in the commercial accounts.

12. Capital allowances give taxpayers relief for certain kinds of expenditure. The Act deals with who gets relief for what expenditure, when and how.

13. Allowances are available mainly for expenditure on:

- plant and machinery;
- industrial buildings;
- agricultural buildings;
- mineral extraction;
- research and development;
- know-how;
- patents;
- dredging; and
- dwelling-houses let on assured tenancies.

14. Capital expenditure does not necessarily qualify for any of these allowances. For example, expenditure on commercial buildings normally gives no entitlement to allowances.

15. Some allowances are given only for expenditure incurred in a specific period.

History of capital allowances

16. The Customs and Inland Revenue Act 1878 introduced deductions in respect of capital expenditure. It required "the Commissioners to allow such deduction as they may think just and reasonable as representing the diminished value by reason of wear and tear during the year of any machinery or plant used for the purposes of the concern".

17. Allowances for mills, factories and the like were introduced in 1918.

18. The modern era of capital allowances started with the Income Tax Act 1945. This abolished most previous deductions and allowances. (The main exception was scientific research which had been covered by the Finance Act 1944.) It introduced in their place a new system of initial and annual allowances. These covered industrial buildings, plant and machinery, mines, oil wells and other mineral deposits, agricultural buildings and works and patent rights. There were also balancing allowances and charges which, very broadly, gave an extra allowance when an asset was sold or imposed a charge so that the net allowances in total matched the actual depreciation.

19. The basic approach taken in 1945 remains today. Allowances for capital expenditure reduce a person's income or profits for tax purposes. Balancing charges (which may arise when, for example, people sell things) increase their income or profits. But many changes have been made to the legislation since 1945.

20. Investment allowances were given at various times in the 1950s and 1960s. They were followed by cash investment grants.

21. Plant and machinery allowances are by far the most common type of capital allowances. In 1971, a new system of allowances for plant and machinery came in. This gave a special allowance called a first-year allowance in the year expenditure was incurred. The balance of expenditure left over after deducting the first-year allowances was then put into a "pool" of expenditure. Writing-down allowances were given on the balance remaining each year. See paragraph 28 below.

22. First-year allowances were phased out in 1984 but reintroduced in the early 1990s.

23. The rates of allowances for plant and machinery have also changed substantially over the 50-odd years since 1945. The various rates of allowances for writing-down expenditure were reduced in 1962 to just three (15%, 20% and 25%). They were further reduced in 1971 to the single rate of 25%. At the same time, there was a change in the way plant and machinery allowances were calculated to give writing-down allowances on the "pool" of expenditure rather than on each item individually.

24. A 10% rate of writing-down allowances for plant and machinery for overseas leasing was introduced in 1982. A 6% rate for long-life assets was introduced in 1997.

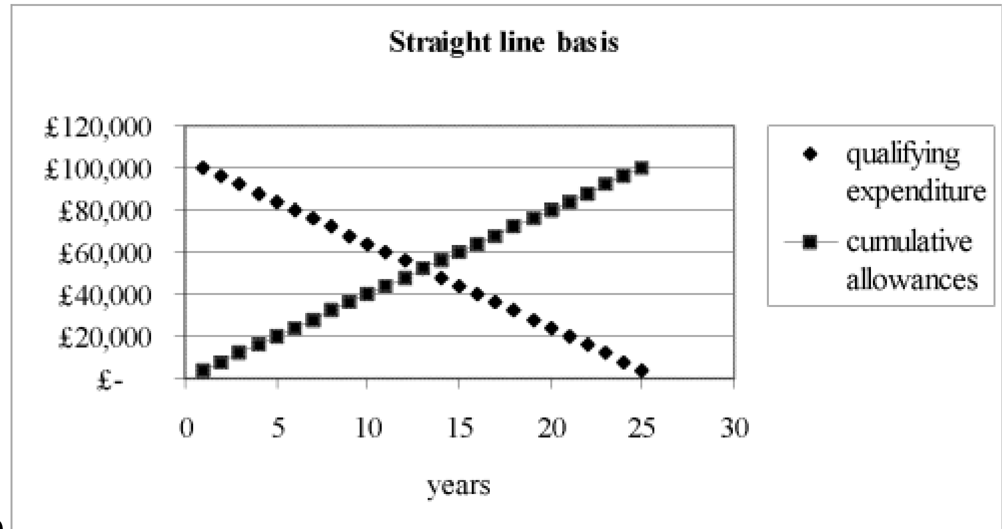
25. Major changes to other allowances were:

- the introduction of allowances for dredging in 1956;
- the extension of industrial buildings allowances in 1978 to some hotels;
- the introduction in 1980 of 100% allowances for some buildings in enterprise zones;
- the introduction in 1982 of allowances for dwelling-houses let on assured tenancies by approved bodies on a temporary basis (for expenditure up to April 1992);
- the revision of agricultural buildings allowances in 1986;
- the introduction of allowances for know-how in 1968 which, together with allowances for patents, were brought into line with other capital allowances in 1986; and also then based on "pools" in broadly the same way as plant and machinery allowances; and
- the introduction of the new system of mineral extraction allowances in 1986.

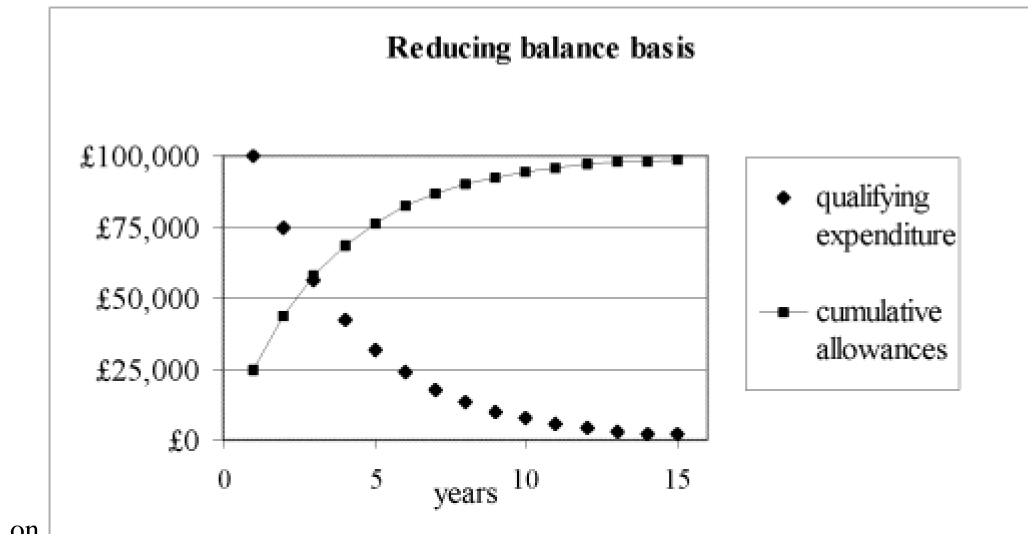
26. This means there are today broadly two ways in which allowances are worked out.

27. Allowances for industrial and agricultural buildings, dredging and assured tenancies are given on what is known as the "straight line basis". This basically means the annual allowance is worked out on the basis of the expenditure which qualifies. Then the same allowances is given year by year until all the expenditure is used up. So the expenditure is "written off" in a straight line over time. E.g. for £100,000 expenditure on a factory there will be

allowances at 4% of £4,000 a year. After 25 years the total allowances will be £100,000.



28. Allowances for plant and machinery, mineral extraction, patents and know-how are given on what is known as the "reducing balance basis". This basically means the amount of the allowance is worked out again each year on the balance of expenditure less allowances left over from the previous year. So the amount of the allowance goes down year by year as the balance of expenditure reduces. This gives more allowances in the early years compared with the straight line basis. E.g. for £100,000 expenditure on plant or machinery the allowances will be £25,000 in year 1, £18,750 in year 2, £14,063 in year 3 and so on.



29. Most of the legislation dealing with capital allowances was consolidated successively as Income Tax Act 1952, Capital Allowances Act 1968 and Capital Allowances Act 1990. The legislation about allowances for patents and know-how was consolidated in the Income and Corporation Taxes Act 1970 and then again in Chapter I of Part XIII of the Income and Corporation Taxes Act 1988.

30. Most subsequent legislation amended or added to the consolidated legislation. But there are exceptions if legislation is in Finance Acts, Income and Corporation Taxes Act 1988 or other Acts.

THE ACT

31. The Act has 581 sections and four Schedules.

32. The sections are arranged as follows:

Part 1 (Introduction) sets out the basic rules on how allowances feed into the calculation of tax, defines some of the key terms used throughout the Act and stops double relief;

Part 2 (Plant and machinery allowances) provides allowances for expenditure on plant and machinery. These are relevant to far more taxpayers than any other allowances. They are in aggregate worth far more than other allowances;

Part 3 (Industrial buildings allowances) provides allowances for expenditure on buildings and structures which are used in defined ways, such as in manufacturing industry or as a hotel;

Part 4 (Agricultural buildings allowances) provides allowances for expenditure on buildings and so on built and first used for farming or other husbandry;

Part 5 (Mineral extraction allowances) provides allowances to the mining and oil industries for, mainly, expenditure on mineral exploration and access or on acquiring mineral assets;

Part 6 (Research and development allowances) provides allowances to traders for certain expenditure on research and development related to a trade;

Part 7 (Know-how allowances) provides allowances to traders for expenditure on certain industrial information or techniques ("know-how");

Part 8 (Patent allowances) provides allowances for expenditure on patent rights;

Part 9 (Dredging allowances) provides allowances if there is expenditure on dredging;

Part 10 (Assured tenancy allowances) provides allowances for expenditure between 1982 and 1992 on dwelling-houses let on assured tenancies (and similar tenancies) by approved bodies;

Part 11 (Contributions) deals with contributions one person makes to another's expenditure. It denies capital allowances for certain expenditure met by contributions from others. But it also gives allowances for certain contributions; and

Part 12 (Supplementary provisions) contains provisions for capital allowances for life assurance businesses; additional VAT; oil licences; partnerships, successions and transfers; and miscellaneous other things. It also defines various terms used in the Act and introduces the Schedules.

33. The Schedules are:

Schedule 1: Abbreviations and defined expressions;

Schedule 2: Consequential amendments;

Schedule 3: Transitionals and savings; and

Schedule 4: Repeals.

COMMENTARY ON SECTIONS

34. The commentary which follows is supported by more detailed material in two annexes.

35. *Annex 1* contains details of the minor changes in the law made by this Act.

36. *Annex 2* gives notes on technical points of interpretation of the sections. These notes concentrate on points where it may not be immediately apparent that the Act preserves the effect of the law.

Glossary

37. The commentary uses a number of abbreviations. They are listed below.

AQE	available qualifying expenditure (see section 55)
BLAGAB	basic life assurance and general annuity business
CAA 1968	the Capital Allowances Act 1968
CAA 1990	the Capital Allowances Act 1990
ESC	extra-statutory concession
EZ	building enterprise zone building
FA 1971	Finance Act 1971 (and similarly FA 1985 and so on)
F(No.2)A	Finance (No. 2) Act
IBA	industrial buildings allowances
ICTA	the Income and Corporation Taxes Act 1988
ICTA 1970	the Income and Corporation Taxes Act 1970
I-E	income less expenses
ISA	individual savings account
ITA 1918	the Income Tax Act 1918 (and similarly ITA 1945)
MOWA	mines, oil wells, etc. allowances
OTA 1975	the Oil Taxation Act 1975
PRT	petroleum revenue tax
R&D	research and development
TCGA 1992	the Taxation of Chargeable Gains Act 1992
TDR	total of any disposal receipts
TMA 1970	the Taxes Management Act 1970
VAT	value added tax

38. There is a list of abbreviations used in the Act at the start of Schedule 1 to the Act.

Part 1: Introduction

Overview

39. Part 1 introduces readers to capital allowances.

40. Chapter 1 sets out the allowances the Act provides for and how they are claimed and given effect generally.

41. Chapter 2 stops expenditure getting double allowances.

Background

42. CAA 1990 does not have an introductory Part. It starts with initial allowances for buildings and structures in enterprise zones. This Act helps readers (especially readers new to capital allowances) by setting out at the start the general provisions in Chapter 1.

43. Chapter 2 is more detailed. It is in Part 1 to signal that taxpayers may have a choice as to which allowances they claim.

Section 1: Capital Allowances

44. This section introduces readers to the allowances (and charges) the Act provides for capital expenditure (and some contributions to certain types of expenditure).

Section 2: General means of giving effect to capital allowances

45. This section is based on parts of sections 137, 140 and 144 of CAA 1990. It sets out the general means of giving effect to the allowances and charges.

46. *Subsection (4)* is based on section 834(2) of ICTA. This applies section 6(4) of ICTA to sections 144 and 145 of CAA 1990. Section 6 is referred to in this Act rather than (as in CAA 1990) leaving readers to discover in section 834(2) of ICTA that section 6(4) applies for the purposes of giving effect to capital allowances for corporation tax.

    Section 6 of ICTA provides that for corporation tax " 'profits' means income and chargeable gains".

Section 3: Claims for capital allowances

47. This section is based mainly on section 140(3) and parts of section 141 of CAA 1990 together with paragraph 79(1) of Schedule 18 to FA 1998. It deals with claims for capital allowances.

48. Before this Act, there was no statutory provision which said that capital allowances must be claimed before they are made. That point was, however, established in a tax case in 1987. See *Note 1* in Annex 2. *Subsection (1)* incorporates the point.

49. In CAA 1990, there are numerous references to claims before readers reach section 140(3). That requires any claim for allowances for income tax in taxing a trade to be claimed in a return. For corporation tax the corresponding provision is in Schedule 18 to FA 1998. *Subsections (2)* and *(3)* make this key point at the start of this Act.

50. *Subsections (4)* and *(5)* give the exceptions in which claims for allowances are not made in a tax return. These are subject instead to the general provisions for claims for income tax or corporation tax. In CAA 1990 section 140(3) (together with section 141(1) and (5)) provides for allowances given "by way of discharge or repayment of tax" to be subject to a claim to which section 42 of TMA 1970 applies in contrast to claims in a tax return where it does not. Section 17(3) of CAA 1990 makes additional provision for claims to carry back balancing allowances in connection with certain mines, oil wells, and so on. Section 528(2) of ICTA provides that a claim is required for patent allowances by someone not carrying on a trade. This Act cuts out the potentially misleading term "discharge or repayment" and refers direct to the provisions under which a claim is made other than in a return.

51. *Subsection (5)* refers to paragraphs 54 to 60 of Schedule 18 to FA 1998. Those deal with how such allowances must fall to be claimed for corporation tax purposes. This

is despite the apparent rule in paragraph 79(1) of that Schedule that claims for capital allowances are made in a company's tax return. See *Note 2* in Annex 2.

52. *Subsection (6)* points readers to the provisions in section 42(6) and (7) of TMA 1970. These require claims for capital allowances for a trade, profession or business carried on by a partnership to be claimed in the "partnership return".

Section 4: Capital Expenditure

53. This section is based on section 159(1) and 159(1A) of CAA 1990 and section 532(4) of ICTA. It explains how "capital expenditure" and "capital sums" are used in this Act. Putting these provisions near the start of the Act lets readers see what expenditure does and does not stand a chance of qualifying for allowances.

Section 5: When capital expenditure is incurred

54. This section is based on section 159 of CAA 1990. It determines the time when capital expenditure is incurred.

55. Section 159(3) to (6) of CAA 1990 is expressed in terms of the time an obligation to pay "becomes" unconditional. This section is expressed in terms of when there is first an unconditional obligation to pay. This responds to the question "what if the obligation was never conditional?" See *Note 3* in Annex 2.

Section 6: Meaning of "chargeable period"

56. This section is based on section 160(2) to (6) of CAA 1990 together with parts of sections 161(2) and 147(1) and (2). It defines "chargeable period". This is a term used throughout the Act. It is, broadly, the period for which people work out their entitlement to allowances or liability to charges.

57. *Subsection (1)* gives the general rule. It is based on part of section 161(2) but omits the words which define a "chargeable period related to" the incurring of expenditure, or a sale or other event, as a reference to the chargeable period in which the expenditure is incurred, or the sale or other event takes place. These words reflect the definition before the introduction of self assessment and the amendments made by section 212 of FA 1994. Before self assessment the "chargeable period related to" the incurring of expenditure referred to the chargeable period in which, or to that in the basis period for which, the expenditure was incurred. But they meant the latter if, and only if, the chargeable period was a year of assessment. With the simplification introduced by self assessment this Act can refer directly to expenditure incurred in a chargeable period.

58. *Subsection (1)* refers to the accounting period of a company. Schedule 1 gives that the same meaning as in section 12 of ICTA.

59. *Subsection (2)* gives the general rules for what is the period of account for income tax purposes. Section 160(5) of CAA 1990 applies in terms only to allowances or charges under Parts I to VI and VIII of CAA 1990. In contrast, subsection (2)(b) applies to all Parts of this Act. This is however not a change in the law because the provisions for patents and know-how were previously treated as contained within a particular Part of CAA 1968 and so subject to the same rules; and because R&D allowances are only available to persons carrying on a trade. See *Note 4* in Annex 2.

60. *Subsections (4)* to *(6)* provide exceptions to the general rule for allowances and charges which go into the calculation of profits of a trade, profession or vocation. They are based on section 160(3), (4) and (6) of CAA 1990. Section 160(6) deals, among other things, with two periods of account which coincide. Subsection (4) does not contain any words to reflect the reference in section 160(6) to the coincidence of two periods. This could happen before self assessment with "basis periods". It cannot now. So it has been omitted from this section. See *Note 5* in Annex 2.

Chapter 2: Exclusion of double relief

Overview

61. This Chapter contains provisions designed to prevent allowances being claimed twice in respect of the same expenditure under different Parts.

62. The Chapter also provides a special rule applying to claims for allowances in respect of fixtures. The general effect of the rules in this Chapter is that different people can claim allowances under different Parts in respect of an asset – for example successive owners. But this does not apply for fixtures. In such cases, one person's claim binds a subsequent claimant.

Section 7: No double allowances

63. This section is based on part of section 147(1) and (2) of CAA 1990. It prevents allowances from being claimed under one Part if an allowance has been made under another Part in respect of the same capital expenditure.

64. *Subsection (1)(b)* extends this and prevents allowances from being claimed under different Parts in respect of expenditure on the same asset.

65. Before this Act, patents and know-how allowances were dealt with in ICTA rather than CAA 1990. As a result, they are not covered by section 147 of CAA 1990. *Subsection (2)* replicates this exclusion by excluding Parts 7 and 8 from the rule in this section. In practice, however, this is likely to be of little effect since it is extremely unlikely (even if possible) that expenditure qualifying for allowances under either of these Parts would also qualify for allowances under any other Part. See *Note 6* in Annex 2.

Section 8: No double relief through pooling under Part 2 (plant and machinery allowances)

66. This section is also based on part of section 147(1) and (2) of CAA 1990. It caters for the fact that, if expenditure on plant or machinery has been allocated to a pool, it is not possible to state that an allowance has been made in respect of the expenditure itself even though an allowance may have been made in respect of the pool.

67. Chapter 5 of Part 2 sets out how expenditure on plant and machinery is pooled to arrive at allowances and charges. See also the commentary on Part 2, paragraphs 93 and 94 below.

68. *Subsections (1)* and *(2)* extend section 7 to deal with cases in which, under Part 2, capital expenditure has been allocated to a pool and an allowance or charge has been made in respect of that pool. In such cases, allowances are not available under any other Part (other than Parts 7 and 8) in respect of that expenditure (or on the provision of a related asset).

69. *Subsections (3)* and *(4)* extend section 7 to deal with cases in which an allowance has been made in respect of capital expenditure under a Part other than Part 2. In such cases, that expenditure (or any expenditure on the provision of a related asset) may not also be allocated to a pool under Part 2.

70. *Subsection (5)* makes it clear that this section does not apply to Part 7 or 8. Again, see *Note 6* in Annex 2.

71. CAA 1990 refers to taking "expenditure into account" for the purposes of the plant and machinery rules. This section is more direct in its approach and refers to expenditure being allocated to a pool and allowances or charges being made. However, there is no change effected by use of these different words.

Section 9: Interaction between fixtures claims and other claims

72. This section is based on section 147(2A), (2B) and (2C) and part of section 147(2D) of CAA 1990. It prevents a person from making a claim under one Part in respect of a fixture if a claim for an allowance has been made under another Part in respect of the same fixture. This applies even if the two claims are made by different persons or in respect of different expenditure.

73. *Subsection (1)* provides the rule that prevents a fixtures claim being made if a claim has been made under a Part other than Part 2.

74. *Subsection (2)* relaxes this rule if the earlier claim is made under Part 3 or 6 and section 186 or 187 applies.

75. *Subsection (3)* provides the mirror image of the rule in subsection (1). If, in respect of an asset, a fixture claim has been made then no person may claim an allowance under any other Part in respect of capital expenditure relating to that asset.

76. *Subsection (4)* explains what is meant by "a fixtures claim".

Section 10: Interpretation

77. This section is based on part of section 147(4) of CAA 1990. It provides the interpretation of terms used in the Chapter.

Part 2: Plant and machinery allowances

Overview

78. This Part provides for plant and machinery allowances. These can be first-year allowances, writing-down allowances or balancing allowances. It also provides for balancing charges.

79. Chapters 1 to 3 set out provisions which decide if a person is in a position to claim allowances. Chapter 1 gives first the general rule that a person must have a qualifying activity and qualifying expenditure. It also gives the general rule as to what is qualifying expenditure and some common additional ways a person may be treated as having incurred it. Chapter 2 defines qualifying activities. Chapter 3 makes more detailed provisions as to what is and is not qualifying expenditure.

80. Chapter 4 identifies expenditure which gives entitlement to first-year allowances. This is called first-year qualifying expenditure.

81. Chapter 5 deals with entitlement to first-year allowances, writing-down allowances and balancing allowances; and with liability to balancing charges. Before writing-down allowances can be claimed, qualifying expenditure must be allocated to a pool. Entitlement to allowances or liability to charges then depends on the total amount in the pool. There are separate pools for each qualifying activity. Within each qualifying activity there may be a main pool; class pools for long-life assets and for assets leased outside the UK; and a number of single asset pools. Figure 1 summarises the various pools.

82. Chapters 6 to 16 make additional provisions for particular types of expenditure and for particular circumstances in which plant or machinery is used or subsidised. They modify the requirements of the earlier Chapters. Chapters 8 to 16 require expenditure to be allocated to class pools or single asset pools rather than the main pool for a qualifying activity.

83. Chapter 17 restricts entitlement to plant and machinery allowances in various circumstances.

84. Chapter 18 deals with additional VAT rebates or liabilities under the VAT capital goods scheme. This scheme applies to certain expenditure on land and computers.

85. Chapter 19 sets out how plant and machinery allowances are given effect.

86. Chapter 20 contains supplementary provisions.

History

87. Annual allowances for plant and machinery used in a trade were introduced in 1878. In 1907 a rule was added to prevent the total relief given in respect of an asset from exceeding its cost.

88. In 1945 the first allowances at rates in excess of normal depreciation were introduced to encourage investment.

89. Since 1971, the legislation has referred to accelerated allowances for the period in which expenditure is incurred as “first-year allowances”.

90. FA 1984 phased out first-year allowances as part of a wide-ranging reform of business taxation. First-year allowances at 40% were re-introduced for one year in 1992-93. In 1997 they were re-introduced for one year at 50% for spending by small and medium-sized businesses only. This was extended, at 40%, for 1998-99 and 1999-2000. In FA 2000 the allowances were made indefinite.

91. First-year allowances have also been introduced, on a temporary basis, for expenditure by small and medium-sized enterprises on plant and machinery for use in Northern Ireland and by small enterprises on information and communication technology equipment.

92. Balancing allowances and balancing charges were also introduced in 1945 to bring the total allowances given on an asset into line with the total depreciation over the period the plant or machinery is owned. This is a principle running through Part II of CAA 1990 – and hence this Part.

93. The calculation of writing-down allowances and balancing adjustments for plant and machinery changed fundamentally in 1971 with the introduction of a statutory scheme of pooling. Expenditure on plant or machinery (less any first-year allowances made) is pooled. Writing-down allowances are then given at a single annual rate on the total of this “qualifying expenditure” in the pool. Pooling simplifies calculations and records. It also removes the need for lots of small balancing adjustments when individual items of plant or machinery are sold, scrapped or otherwise disposed of.

94. In 1971 all expenditure was allocated to the main pool apart from expenditure on cars above the cost threshold, plant or machinery provided or used partly for a trade and partly for other purposes and plant or machinery subject to a wear and tear subsidy. These exceptions kept separate expenditure on a single item of plant or machinery. More such “single asset pools” were added in later years. So too were “class pools” for all expenditure of a given type. The pools added were:

- class pool for leased assets and cars below the cost threshold in FA 1980 (abolished by FA 2000);
- class pool for overseas leasing in FA 1982 (which also modified the class pool introduced in 1980);
- single asset pools for ships in FA 1985;
- single asset pools for short-life assets in FA 1985; and
- class pool for long-life assets in FA 1997.

95. Originally allowances were given only for plant and machinery used in trades. In 1945 the legislation provided also for professions, vocations, employments and offices to be treated like trades with some modifications; and in some circumstances for plant and machinery allowances for lessors. Over the years allowances were extended to other businesses by treating them like trades too – again subject to modifications and conditions.

96. What counts as plant and machinery has also evolved over the years – partly because of judicial decisions and partly by legislation.

Structure of Part 2

97. One way in which CAA 1990 copes with the extensions to the scope of plant and machinery allowances is by treating activities such as professions, vocations and property businesses as if they were trades.

98. Separate pools for expenditure are achieved in CAA 1990 by a similar device. Expenditure incurred for the purposes of a trade (or an activity treated as a trade) is treated as incurred for a separate notional trade.

99. This works. But it means that what appear to be simple references to a trade may mean something more. For example Part II of CAA 1990 starts with the simple statement in section 22:

"(1) Subject to the provisions of this Part, where—

(a) a person carrying on a trade incurs capital expenditure to which this section applies on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and

(b) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure,

there shall be made to him for that period an allowance ("a first-year allowance") …

100. This might lead readers not carrying on a trade to conclude they are not entitled to first-year allowances. But later sections in CAA 1990 mean that the "trade" in paragraph (a) does not have to be a trade. It may be another activity treated as a trade.

101. Similarly readers might take section 24 of CAA 1990 to mean they are not entitled to writing-down allowances if they are not carrying on a trade:

"(1) Subject to the provisions of this Part, where—

(a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and

(b) in consequence of his incurring that expenditure, the machinery or plant belongs or has belonged to him,

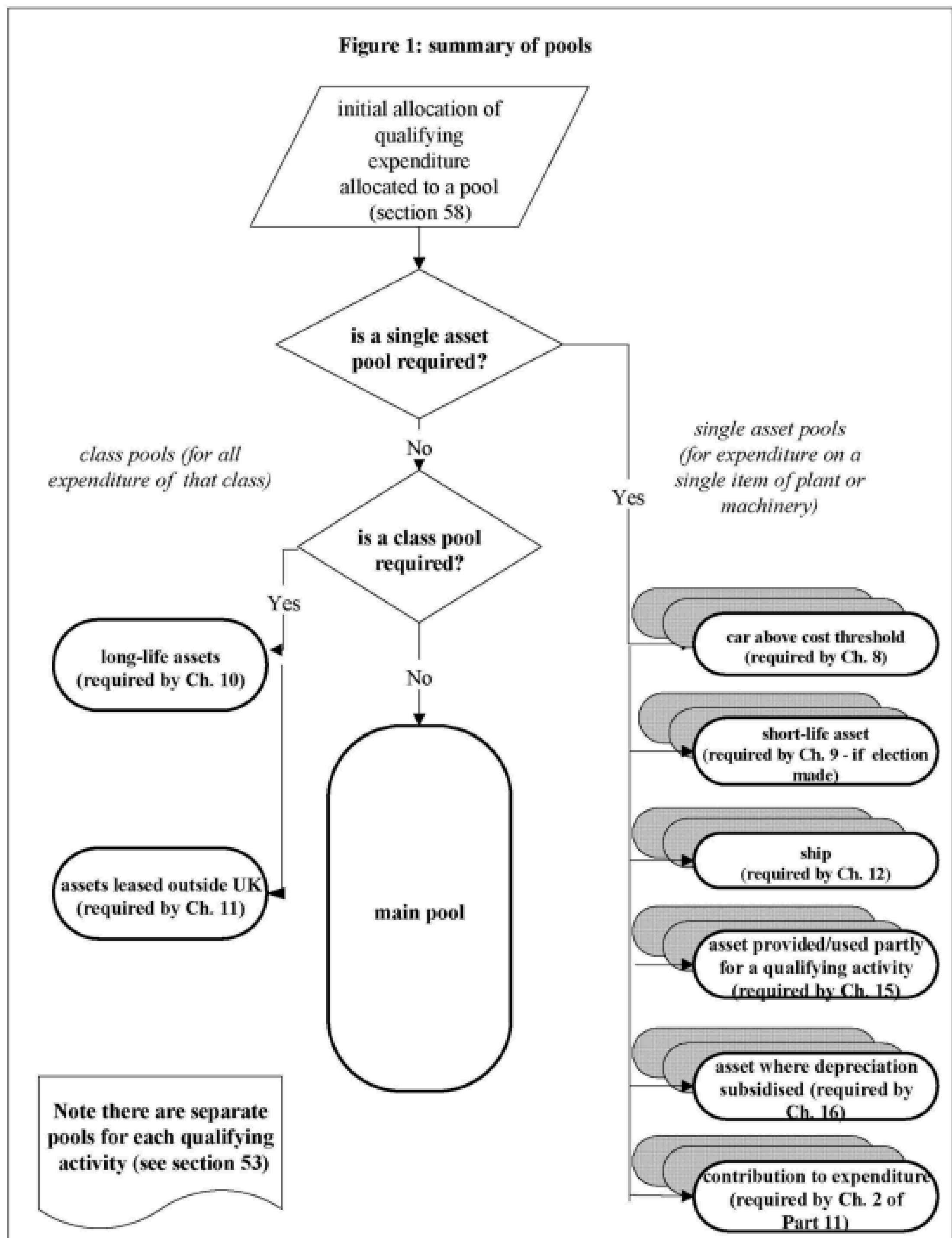
allowances and charges shall be made to and on him in accordance with the following provisions of this section.

102. In fact the "trade" can again be another activity treated as a trade. It may also be a notional trade set up so as to create a separate pool of expenditure. In addition, expenditure which is not on plant or machinery may be treated as if it were under later provisions; or people may be treated as incurring expenditure on plant or machinery they have as a result of a gift.

103. A different approach is taken to these points in this Act. It:

- deals explicitly with the various activities which CAA 1990 treats as or deems to be trades. The term "qualifying activity" is used to refer to these. See section 15.

- deals explicitly with "pools" in place of notional trades (or notional qualifying activities as they would have become); and
- makes clear to readers coming to Part 2 (possibly for the first time) what is required for entitlement to allowances.



104. The structure of Part 2 of this Act is accordingly different from Part II of CAA 1990. There are three main blocks of sections:

- Chapters 1 to 3 deal with qualifying activities and qualifying expenditure. A person who has a qualifying activity and qualifying expenditure is normally entitled to allowances of some kind;

- Chapters 4 to 18 deal with the entitlement to allowances (or liability to charges). The order of this material is a balance between several criteria: for example how often the legislation applies in practice; the benefits of putting similar provisions together; introducing concepts in a logical order; and readers' expectations. There is no one right answer as a different mix of provisions is relevant to different taxpayers, and to different transactions by one taxpayer; and

- Chapter 19 then sets out how allowances are given effect.

105. Another difference in approach in this Act from CAA 1990 is in the use of the term "qualifying expenditure".

106. Part II of CAA 1990 uses this term to mean the sum of expenditure added to a pool for a chargeable period plus the balance (if any) of expenditure added in earlier chargeable periods. The expenditure added to a pool may be the same amount as the capital expenditure incurred on plant or machinery. But it may also be less. A simple example is if a first-year allowance is claimed. Then the amount which counts as qualifying expenditure in CAA 1990 is the balance left after the first-year allowances.

107. There is no term in CAA 1990 for the amount of expenditure on which someone can get allowances of one kind or another – first-year allowances and/or writing-down allowances. It is not the capital expenditure incurred as not all capital expenditure qualifies. So Part II of CAA 1990 has repeatedly to refer to expenditure by its characteristics. An example is section 37(1) of CAA 1990.

"(1) This section applies where—

(a) a person carrying on a trade ("the trader") incurs capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade;

108. In this Act qualifying expenditure means expenditure on which a person may get first-year allowances or writing-down allowances (or both). This is broadly in line with other Parts of this Act which also use the term qualifying expenditure (although what is and is not qualifying expenditure differs from Part to Part). Using the term qualifying expenditure in this way allows simpler references. An example is in section 83.

"Plant or machinery in respect of which qualifying expenditure has been incurred is a short-life asset if—

109. Other terms then follow from this use of qualifying expenditure. The table below is a simplified summary.

in this Act	***in CAA 1990***
qualifying expenditure (see section 11)	no equivalent term: broadly capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of a trade which belongs to the person incurring it (see section 25(1)(a))
available qualifying expenditure (see section 57)	qualifying expenditure
unrelieved qualifying expenditure (see section 59)	no equivalent term: section 25(1)(b) provides that qualifying expenditure includes "if for the chargeable period immediately preceding the chargeable period in question there was an excess of qualifying expenditure over disposal value, the balance of that excess after

in this Act	*in CAA 1990*
	deducting any writing-down allowance made by reference thereto".

Chapter 1: Introduction

Overview

110. This Chapter introduces Part 2 by giving the general conditions for plant and machinery allowances and dealing with some common additional cases.

111. Section 11 identifies the general requirement for plant and machinery allowances: a person must carry on a qualifying activity for which they incur qualifying expenditure. If a person carries on more than one qualifying activity each is looked at separately to decide entitlement to allowances. These general rules are subject to other provisions which amend or replace them in various circumstances.

112. Sections 12 to 14 provide for plant and machinery allowances if a person does not meet the general conditions because:

- expenditure was incurred before the start of the qualifying activity in question;
- expenditure was incurred for another purpose before the plant or machinery starts to be used for the qualifying activity; or
- plant or machinery used for a qualifying activity was a gift.

Section 11: General conditions as to availability of plant and machinery allowances

113. This section is based in part on sections 22(1)(a) and 24(1)(a) and (b) of CAA 1990. It gives the general conditions for plant and machinery allowances. It uses the terms "qualifying activity" and "qualifying expenditure" which are central to entitlement to allowances under this Part.

114. *Subsection (1)* sets out the preliminary requirement for the whole of Part 2. Allowances are available if a person carries on a qualifying activity and incurs qualifying expenditure.

115. *Subsection (2)* is a signpost to Chapter 2 of Part 2 which gives the meaning of "qualifying activity".

116. *Subsection (3)* sets up separate calculations for each qualifying activity.

117. *Subsection (4)* gives the general rule for qualifying expenditure. Subsection (4)(a) uses "wholly or partly" for the purposes of the qualifying activity instead of "wholly and exclusively" used by sections 22(1)(a) and 24(1)(b) of CAA 1990. The use of that term at the start of Part II is potentially misleading. Readers may conclude they are not entitled to plant and machinery allowances if they use an asset partly for other purposes. Yet section 79 of CAA 1990 makes explicit provision for allowances for plant or machinery provided or used partly for a qualifying activity and partly for other purposes. This subsection flags this at the start.

118. Subsection (4)(b) uses "owns". CAA 1990 refers to plant or machinery which "belongs" to a person in sections 22(1)(b) and 24(1)(b) (and elsewhere). This is a change in the language only. See *Note 7* in Annex 2.

119. *Subsection (5)* is a signpost to Chapter 3 of Part 2 which contains detailed provisions about plant and machinery and qualifying expenditure.

Section 12: Expenditure incurred before qualifying activity carried on

120. This section is based on section 83(2) of CAA 1990. It provides for expenditure incurred before the qualifying activity is carried on to be treated as incurred when the activity is started. Without this the expenditure could not be qualifying expenditure. It complements the trading income rule in section 401 of ICTA.

Section 13: Use for qualifying activity of plant or machinery provided for other purposes

121. This section is based on section 81(1) to (2AB) of CAA 1990. It provides for a person to be treated as having incurred qualifying expenditure if they start to use in a qualifying activity plant or machinery they provided for some other purpose. Without this section such plant or machinery would give no entitlement to allowances.

122. Section 81 of CAA 1990 also deals with gifts. In this Act they are dealt with in section 14. Dividing the material in this way brings out for readers the distinct ways they may be entitled to allowances.

Section 14: Use for qualifying activity of plant or machinery which is a gift

123. This section is based on section 81 of CAA 1990. It contains rules for plant or machinery that was gifted to the person carrying on the qualifying activity.

124. The section is similar to section 13. The plant or machinery received as a gift comes in at market value.

125. There is no equivalent of the anti-avoidance rules in section 13(4) and (5).

126. The anti-avoidance rule in section 81(3) of CAA 1990 has been moved to Chapter 17 of Part 2 – see section 213(3).

Chapter 2: Qualifying activities

Overview

127. This Chapter determines whether or not a person is carrying on a qualifying activity. This is a necessary condition of entitlement to plant and machinery allowances (see Chapter 1 of Part 2).

128. Section 15 lists the qualifying activities. It also points to provisions in Chapters 3 and 8 of Part 2 which affect particular qualifying activities.

129. The rest of this Chapter contains definitions of, and further provisions about, particular qualifying activities.

Section 15: Qualifying activities

130. This section is based on various sections of CAA 1990 which deem the activities listed to be trades. It also makes a minor change.

131. *Subsection (1)(f)* makes concerns listed in section 55 of ICTA a type of qualifying activity. The profits of these concerns are charged to tax under Case I of Schedule D by section 55(1) of ICTA but are not trades. As they are taxed under Schedule D they cannot be Schedule A businesses. That means Part II of CAA 1990 does not cater for them. This Act does so by making them qualifying activities. See *Change 1* in Annex 1.

132. *Subsection (1)(g)* provides for the management of an investment company to be a qualifying activity. It derives from section 28(1) of CAA 1990 which refers to "the management of the business of an investment company". This is new wording but is not a change. See *Note 8* in Annex 2.

133. The final words provide that an activity is only a qualifying activity to the extent that the profits or gains from it are chargeable to tax. They are based on section 83(2A) of CAA 1990. Exceptions to this rule can be found in Chapters 16, 17 and 20 of Part 2.

Section 16: Ordinary Schedule A businesses

134. This section defines "ordinary Schedule A business" for the purposes of this Part. This term is not used in CAA 1990. It is used in this Act to distinguish Schedule A businesses which are not furnished holiday lettings businesses from those which are.

Section 17: Furnished holiday lettings businesses

135. This section is based on section 29 of CAA 1990. It defines furnished holiday lettings businesses.

136. *Subsection (3)* applies the definition in section 504 of ICTA. This approach is taken here (and in some other places in the Act) in order to:

- make clear that precisely the same definition is used; and
- avoid duplication of legislation (with the risk that the definitions may diverge if one is amended but not the other by accident rather than design).

137. The vast majority of readers have access to that legislation. Increasingly they have electronic access (with hyperlinks to such cross-references). But for ease of reference in these notes:

Section 504 of ICTA (Supplementary provisions)

"(2) A letting—
 (a) is a commercial letting if it is let on a commercial basis and with a view to the realisation of profits; and
 (b) is of furnished accommodation if the tenant is entitled to the use of furniture.

(3) Accommodation shall not be treated as holiday accommodation for the purposes of this section unless—
 (a) it is available for commercial letting to the public generally as holiday accommodation for periods which amount, in the aggregate, to not less than 140 days;
 (b) the periods for which it is so let amount in the aggregate to at least 70 days; and
 (c) for a period comprising at least seven months (which need not be continuous but includes any months in which it is let as mentioned in paragraph (b) above) it is not normally in the same occupation for a continuous period exceeding 31 days.

(4) Any question whether accommodation let by any person other than a company is, at any time in a year of assessment, holiday accommodation shall be determined—
 (a) if the accommodation was not let by him as furnished accommodation in the preceding year of assessment but is so let in the following year of assessment, by reference to the 12 months beginning with the date on which he first so let it in the year of assessment;
 (b) if the accommodation was let by him as furnished accommodation in the preceding year of assessment but is not so let in the following year of assessment, by reference to the 12 months ending with the date on which he ceased so to let it in the year of assessment; and
 (c) in any other case, by reference to the year of assessment.

(5) Any question whether accommodation let by a company is at any time in an accounting period holiday accommodation shall be determined—

(a) if the accommodation was not let by it as furnished accommodation in the period of 12 months immediately preceding the accounting period but is so let in the period of 12 months immediately following the accounting period, by reference to the 12 months beginning with the date in the accounting period on which it first so let it;

(b) if the accommodation was let by it as furnished accommodation in the period of 12 months immediately preceding the accounting period but is not so let by it in the period of 12 months immediately following the accounting period, by reference to the 12 months ending with the date in the accounting period on which it ceased so to let it;

(c) in any other case, by reference to the period of 12 months ending with the last day of the accounting period.

(6) Where, in any year of assessment or accounting period, a person lets furnished accommodation which is treated as holiday accommodation for the purposes of this section in that year or period ("the qualifying accommodation"), he may make a claim under this subsection, within the time specified in subsection (6A) below, for averaging treatment to apply for that year or period to that and any other accommodation specified in the claim which was let by him as furnished accommodation during that year or period and would fall to be treated as holiday accommodation in that year or period if subsection (3)(b) above were satisfied in relation to it.

(6A) The time mentioned in subsection (6) above is—

(a) in the case of a claim for the purposes of income tax, the period ending with the first anniversary of the 31st January next following the year of assessment in which the accommodation was let;

(b) in the case of a claim for the purposes of corporation tax, the period of two years beginning at the end of the accounting period in which the accommodation was let.

(7) Where a claim is made under subsection (6) above in respect of any year of assessment or accounting period, any such other accommodation shall be treated as being holiday accommodation in that year or period if the number of days for which the qualifying accommodation and any other such accommodation was let by the claimant as mentioned in subsection (3)(a) above during the year or period amounts on average to at least 70.

(8) Qualifying accommodation may not be specified in more than one claim in respect of any one year of assessment or accounting period.

(9) For the purposes of this section a person lets accommodation if he permits another person to occupy it, whether or not in pursuance of a lease; and "letting" and "tenant" shall be construed accordingly.

138. *Subsection (4)* provides for all necessary apportionments under this Part if only part of accommodation is holiday accommodation.

Section 18: Management of investment companies

139. This section is based on section 28 of CAA 1990. It defines the qualifying activity of "management of an investment company".

140. Subsection (1) applies the definition of an investment company in ICTA. An investment company may carry on a trade or other qualifying activity. But subsection (2) provides that it is only a limited range of activities which are the "management of an investment company". These are activities expenditure on which would fall within "expenses of management" in section 75 of ICTA. This defines the qualifying activity for capital allowances in line with the treatment of expenses.

141. Section 28(1) of CAA 1990 refers to "the management of the business of an investment company". This has been shortened in this section and section 15(1)(g) to "management of an investment company". This does not change the effect of the legislation. See *Note 8* in Annex 2.

Section 19: Special leasing of plant or machinery

142. This section is based on section 61(1) of CAA 1990 and section 434E(2) of ICTA. It defines the qualifying activity of "special leasing" for plant or machinery which is hired out otherwise than in the course of any other qualifying activity.

143. *Subsection (1)* introduces and defines the term "special leasing". This term is not used in CAA 1990. That provides for such an activity to be treated as a trade separate from any other trade the person carries on. Other provisions then have to refer to such activities in terms of the legislation which define them. For example in section 31(1)(c) of CAA 1990:

"the actual trade is not a separate trade which the shipowner is treated as carrying on by virtue of section 61(1).

144. The term "special leasing" allows more direct references – see for example section 128(2).

145. The section refers to "hiring out" plant or machinery. CAA 1990 refers to plant or machinery "let". The use of the more colloquial phrase makes no practical difference. The section also omits the words in section 61(1) of CAA 1990 which provide that it does not matter whether the lessee does or does not carry on a qualifying activity. These are no longer needed. See *Note 9* in Annex 2.

146. *Subsection (3)* is based on section 61(1)(b) of CAA 1990. It states when the separate qualifying activity is permanently discontinued. This is not clear in CAA 1990. Section 61(1)(b) of CAA 1990 provides for the plant or machinery to be treated as being used wholly for purposes other than those of the deemed trade when the lessor permanently ceases to let the plant or machinery otherwise than in the course of a trade. This requires the lessor to bring a disposal event into account. But it does not explicitly provide for the deemed trade to be permanently discontinued. However, any other interpretation would leave the lessor with:

- no entitlement to a balancing allowance;
- entitlement only to writing-down allowances for an indefinite period, in ever decreasing amounts; and
- possibly allowances which are stranded because the lessor could only use them against income from letting the plant or machinery in question.

147. Subsection (3) accordingly reflects the alternative view that section 61(1) of CAA 1990 also provides for the deemed trade to end. See *Change 15* in Annex 1.

148. *Subsection (5)* is based on section 434E(2) ICTA. That (and section 434D ICTA) were introduced by section 51 of, and Schedule 8 to, FA 1995. As the legislation relates directly to capital allowances it is incorporated in this Act.

149. Section 61(8) of CAA 1990 is omitted from this section. It provides for a "lease" to mean also an agreement for a lease. It is now unnecessary except in relation to section 61(4) of CAA 1990 (see section 70 and paragraph 353 below).

Section 20: Employments and offices

150. This section is based on sections 198(2) and 314 of ICTA. It provides that some employments and offices are not qualifying activities as such.

151. *Subsection (1)* is based on section 314 of ICTA (divers and diving supervisors). Divers and diving supervisors operating in the North Sea normally have contracts of employment as a matter of general law. They would then be employees for tax purposes. But section 314 of ICTA provides that "the Income Tax Acts shall have effect as if" they were carrying on a trade. CAA 1990 is part of the "the Income Tax Acts" as defined in section 831(1)(b) of ICTA. So for the purposes of the capital allowances legislation North Sea divers have trades rather than employments. Subsection (1) puts this explicitly in terms of qualifying activities.

152. *Subsections (2)* and *(3)* are based on section 198(2) of ICTA. They exclude from plant and machinery allowances employments and offices which are taxed on the "remittance basis" – that is, where only income remitted to the United Kingdom is taxed. Such remittances will already be net of any capital expenditure incurred out of that income.

Chapter 3: Qualifying Expenditure

Overview

153. This Chapter supplements the general rules in section 11 with further provisions about qualifying expenditure.

154. Sections 21 to 25 exclude expenditure on the provision of buildings, structures, land and certain other assets from being expenditure on plant or machinery. They define what is and is not a building for this purpose.

155. Section 26 provides for certain costs of demolishing plant or machinery to be treated as expenditure on the provision of plant or machinery.

156. Sections 27 to 33 allow some special types of expenditure to be qualifying expenditure. These are, broadly, expenditure on:

- thermal insulation of industrial buildings;
- fire safety if required by a notice under the relevant legislation;
- safety at sports grounds if required to comply with a certificate under the relevant legislation; and
- personal security if there is a special threat to an individual's security arising from their work.

157. Sections 34 to 38 exclude or restrict some special types of expenditure. These are, broadly, expenditure on:

- accommodation by MPs and some others;
- plant or machinery for a dwelling-house for certain qualifying activities;
- plant or machinery by employees which is not necessary for the performance of their duties;
- plant or machinery if the depreciation is met in full by subsidies; and
- production animals subject to a "herd basis" election (see Schedule 5 to ICTA).

158. Other provisions in this Part also treat expenditure as being expenditure on plant or machinery. See in particular Chapter 7 (computer software) and Chapter 18 (additional VAT liabilities and rebates).

Section 21: Buildings

159. This section is based on paragraphs 1(1), (2) and 5(1) of Schedule AA1 to CAA 1990. It brings together the material excluding buildings from being plant or machinery.

160. *Subsection (1)* sets out the general rule that buildings are not plant or machinery.

161. *Subsection (2)* is based on paragraph 5(2) of Schedule AA1 to CAA 1990. It provides that references to the provision of a building include the construction or acquisition of a building.

162. *Subsection (3)(a)*, *(b)* and *(c)* treats assets incorporated in or connected with a building as part of the building and list A provides a list of assets treated as buildings, whether or not they would otherwise be so.

163. *Subsection (4)* provides a cross-reference to the list of expenditure unaffected by this section in section 23.

164. Chapter 14 provides rules under which allowances can be claimed for fixtures which are assets incorporated in buildings and which in law become part of the building. An asset cannot qualify under Chapter 14 as a fixture unless it is plant or machinery in the first place (see section 172). As the fixture is part of a building, section 25 means that it cannot be plant or machinery unless it comes within the exceptions in section 23.

Section 22: Structures, assets and works

165. This section is based on paragraphs 2 and 5 of Schedule AA1 to CAA 1990. It brings together material excluding structures from the meaning of plant or machinery.

166. *Subsection (1)* sets out the general exclusion of structures, and incorporates list B. The assets in list B are excluded as structures whether or not they are structures in an ordinary sense.

167. *Subsection (2)* incorporates the rule in paragraph 5(1) of Schedule AA1 to CAA 1990 that the cost of construction or acquisition is part of the cost of the structure.

168. *Subsection (3)(a)* is based on paragraph 5(1)(a) and defines "structure". *Subsection 3(b)* brings in the definition of land from paragraph 5(3). This is needed in subsection (1)(b).

Section 23: Expenditure unaffected by sections 21 and 22

169. This section is based on column 2 of Table 1 in paragraph 1, column 2 of Table 2 in paragraph 2 and paragraph 1(3) of Schedule AA1 together with ESC B50. It also makes two minor changes.

170. The various types of expenditure detailed in this section may be plant or machinery even if they are buildings or structures covered by sections 21 and 22 (which stop buildings and structures being plant).

171. *Subsection (1)* says that sections 21 and 22 do not apply to expenditure in subsection (2).

172. *Subsection (2)* gives a list of other provisions which treat particular items of expenditure as plant.

173. *Subsection (3)* says that the items in list C are unaffected by sections 21 and 22.

174. *Subsection (4)* includes list C. This is made up from column 2 from both Table 1 and Table 2 of Schedule AA1 to CAA 1990. It also includes the items in paragraph 1(3).

175. The merger of the columns involves a minor change. In Schedule AA1 the columns apply differently:

- whether a *building* is plant is unaffected by the Schedule for assets in column 2 of Table 1; and
- whether a *structure* is plant is unaffected by the Schedule for assets which are within either column 2 of Table 1 or column 2 of Table 2 (paragraph 2(3) of Schedule AA1 provides this rule).

176. Merging the Tables in this Act in principle increases the range of expenditure on buildings which is unaffected by the exclusion of buildings from the definition of plant. See *Change 2* in Annex 1.

177. Item 17 of list C is based on paragraph 5(2) of Schedule AA1 to CAA 1990. It adds expenditure on glasshouses to the list of unaffected expenditure instead of having it as a separate exclusion at the end of the Chapter.

178. *Subsection (5)* incorporates the extended meaning of "caravan" from ESC B50. This allows certain things that might not be thought of as caravans to be included as caravans if they are treated as such by section 29(1) of the Caravan Sites and Control of Development Act 1960 or (in Northern Ireland) section 25(1) of the Caravans Act (Northern Ireland) 1963. See *Change 3* in Annex 1.

Section 24: Interests in land

179. This section is based on paragraph 5 of Schedule AA1 to CAA 1990. It provides that expenditure on the acquisition of an interest in land is not expenditure on plant or machinery.

180. *Subsection (1)*states the exclusion and *subsection (2)* qualifies the meaning of "land".

181. *Subsection (3)* links the meaning of "interest in land" with that in section 175.

Section 25: Building alterations connected with installation of plant or machinery

182. This section is based on section 66 of CAA 1990. It allows expenditure on alterations to an existing building to qualify as expenditure on plant or machinery if those alterations are incidental to the installation of plant or machinery.

Section 26: Demolition costs

183. This section is based on section 62 of CAA 1990. It also makes a minor change. It provides that if the plant or machinery is replaced, then the net cost of demolition is added to the expenditure incurred on the new plant or machinery. If it is not replaced, then the net cost of demolition is added to the pool of qualifying expenditure for the chargeable period in which the demolition takes place.

184. The minor change is in the circumstances in which the section applies. Section 62 of CAA 1990 applies only if plant or machinery "is in use" for the qualifying activity when demolished. This section provides relief if "the last use" of the plant or machinery was for the qualifying activity. See *Change 4* in Annex 1.

185. The net cost of demolition is the cost less any money received for the remains.

Section 27: Application of Part to thermal insulation, safety measures, etc.

186. This section is based on parts of sections 69 to 71 of CAA 1990. It provides for expenditure of the types defined in sections 28 to 33 to be qualifying expenditure. It does so by treating the expenditure as meeting the general conditions for plant and machinery allowances. Then the subsequent provisions of this Part apply without additional provisions to cater only for these relatively rare types of expenditure.

187. *Subsection (1)(b)* means these provisions do not apply if an allowance under this Part or a deduction in respect of the expenditure could be made. This differs from CAA 1990 in two respects:

- in section 67 of CAA 1990 there is no such exclusion for thermal insulation; and
- in sections 69 and 70 of CAA 1990 (fire safety and safety at sports grounds) the exclusion goes wider so as to deny plant and machinery allowances if capital allowances can be claimed under any other Part.

188. These differences are largely due to the way the legislation has been revised over the past 25 years with some consequential changes missed. This Act provides a consistent basis for all these types of expenditure by making minor changes. See *Change 5* in Annex 1.

189. Subsection (1) incorporates the effect of section 161(3) of CAA 1990 in this section. See *Note 74* in Annex 2.

Section 28: Thermal insulation of industrial buildings

190. This section is based on section 67 of CAA 1990. It deals with expenditure incurred on thermal insulation of industrial buildings.

Section 29: Fire safety

191. This section is based mainly on section 69 of CAA 1990. It deals with expenditure on fire safety.

192. *Subsection (4)* uses somewhat different language from CAA 1990. Since this relief was first introduced, the relevant fire safety legislation has been amended. This section adopts the language from the amended legislation. See *Note 10* in Annex 2.

193. *Subsections (5)* and *(6)* are based on ESC B16 which extends the scope of section 69 to include fire precautions taken under Northern Ireland legislation. See *Change 6* in Annex 1.

Section 30: Safety at designated sports grounds

194. This section is based on section 70 of CAA 1990. It deals with expenditure to meet required safety precautions under the Safety of Sports Grounds Act 1975.

Section 31: Safety at regulated stands at sports grounds

195. This section is based on section 70 of CAA 1990. It deals with safety precautions taken under Part III of the Fire Safety and Safety of Places of Sport Act 1987.

Section 32: Safety at other sports grounds

196. This section is based on section 70 of CAA 1990. It deals with safety precautions taken to comply with the Safety of Sports Grounds Act 1975 if a designation order (under section 1 of that Act) is not made but a local authority certifies that the expenditure would fall within a designation order.

Section 33: Personal security

197. This section is based on sections 71 and 72 of CAA 1990. It deals with expenditure to meet a special threat to a person’s physical security.

198. The list of relevant qualifying activities for this purpose reflects the extension of the meaning of “trade, profession or vocation” in section 71 of CAA 1990 by sections 28A, 29 and 161(2A) of CAA 1990. See *Note 11* in Annex 2.

Section 34: Expenditure by MPs and others on accommodation

199. This section is based on section 74 of CAA 1990. It deals with certain expenditure by Members of Parliament (and other similar representatives) on accommodation.

Section 35: Expenditure on plant or machinery for use in dwelling-house not qualifying expenditure in certain cases

200. This section is based on sections 28A and 61(2) of CAA 1990. It prevents expenditure incurred in providing plant or machinery in a dwelling house being qualifying

expenditure. It applies to Schedule A businesses, overseas property businesses and special leasing.

201. Section 28A(4) of CAA 1990 provides for apportionment if expenditure is incurred on plant or machinery partly for use in a dwelling-house and partly for other purposes. There is no such rule for section 61 (which deals with activities known in this Act as "special leasing"). But section 79 of CAA 1990 provides an equivalent rule for reducing allowances. That has the same effect. See *Note 12* in Annex 2.

Section 36: Restriction on qualifying expenditure in case of employment or office

202. This section is based on section 27(2) of CAA 1990. It adds the "necessarily" condition to the general conditions for plant and machinery allowances in the case of qualifying activities which are employments and offices. This brings the capital allowances requirements into line with other Schedule E reliefs.

Section 37: Exclusion where sums payable in respect of depreciation

203. This section is based on section 80(1) of CAA 1990. It deals with the general exclusion if sums are received to cover all the depreciation of the plant or machinery.

204. The use of "depreciation" is different from CAA 1990 (which refers instead to "wear and tear"). Depreciation is preferred as more familiar. It is also on the face of it a wider term. But in context it is thought to make no difference to entitlement to allowances. See *Note 13* in Annex 2.

Section 38: Production animals etc.

205. This section is based on section 82(2) of CAA 1990. It stops capital allowances being claimed on animals which are subject to the special rules for production animals in Schedule 5 to ICTA (the "herd basis").

Chapter 4: First-year qualifying expenditure

Overview

206. This Chapter defines qualifying expenditure which gives entitlement to first-year allowances (subject to the person owning the plant or machinery in question in the chargeable period the expenditure is incurred – see section 52).

207. Section 39 introduces the three categories of expenditure in chargeable periods covered by the Act which may give rise to first-year allowances.

208. Sections 40 to 43 deal with expenditure which qualifies as incurred for Northern Ireland purposes by small or medium-sized enterprises. The expenditure must be incurred on or before 11 May 2002. They also provide for allowances to be withdrawn in some circumstances if plant or machinery is subsequently used outside Northern Ireland.

209. Section 44 provides for first-year allowances for qualifying expenditure incurred by a small or medium-sized enterprise which is not expenditure on a long-life asset (see Chapter 10).

210. Section 45 provides for first-year allowances for qualifying expenditure incurred on or before 31 March 2003 by a small enterprise on information and communications technology.

211. Section 46 defines expenditure which is excluded from all three categories of first-year qualifying expenditure.

212. Sections 47 to 49 decide whether or not an enterprise is small or medium-sized.

213. Section 50 provides that section 12 does not affect when expenditure is treated as incurred for the purposes of deciding what is and is not first-year qualifying expenditure.

214. Section 51 provides for exchange of information in connection with section 40.

215. Provisions relating to first-year allowances for earlier years are preserved in paragraphs 46 to 51 of Schedule 3 for the purposes of the legislation for additional VAT liabilities.

Section 39: First-year allowances available for certain types of qualifying expenditure only

216. This section is based in part on section 22(1) of CAA 1990. But it is mainly drafted to introduce this Chapter. It sets out the different kinds of first-year qualifying expenditure so readers can see quickly if they are likely to have expenditure which qualifies.

217. The three types of expenditure in this section cover the overwhelming majority of practical circumstances. But a very small minority may also have first-year qualifying expenditure as a result of additional VAT liabilities. See section 236. It is also possible for entitlement to first-year allowances to arise in respect of additional VAT liabilities:

- in a chargeable period to which the Act applies; but
- under the provisions for first-year allowances for expenditure between 1992 and 1993 or between 1997 and 1998.

218. Additional VAT for those periods is likely to be a practical issue for very few people indeed in the chargeable periods covered by the Act. The provisions are only capable of having effect until the end of the period for VAT adjustments (5 or 10 years). So the necessary provisions are in paragraphs 46 to 51 of Schedule 3 to the Act.

Section 40: Expenditure incurred for Northern Ireland purposes by small or medium-sized enterprises

219. This section is based on parts of section 22(3CA) and (3CB) of CAA 1990. It gives the conditions which must be met for first-year qualifying expenditure under this heading.

220. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise.

Sections 41 and 42: Exclusions from section 40

221. These sections are based mainly on section 22(3CC), (3CE), (6D) and (6E) of CAA 1990. They exclude some expenditure from being first-year qualifying expenditure under section 40.

222. *Section 41* gives exclusions according to the nature of the expenditure.

223. *Section 42* excludes plant and machinery intended for use partly outside Northern Ireland if first-year allowances could be a main benefit of the expenditure qualifying.

Section 43: Effect of plant or machinery subsequently being primarily for use outside Northern Ireland

224. This section is based on section 22B of CAA 1990. It stops expenditure being first-year qualifying expenditure under section 40 if there is a change in the use of the plant or machinery and withdraws any first-year allowances which have been made.

225. *Subsection (1)* withdraws entitlement to first-year allowances if plant or machinery is used or held for use primarily outside Northern Ireland in the period defined by subsections (2) and (3). That is five years from the date of the expenditure if it is over £3.5 million and two years if not.

226. *Subsection (4)* allows first-year allowances already made to be withdrawn.

227. *Subsections (5)* and *(6)* require taxpayers to notify the Inland Revenue within three months if, as a result of this section, their tax return needs amendment.

Section 44: Expenditure incurred by small or medium-sized enterprises

228. This section is based on section 22(3D) of CAA 1990. It defines first-year qualifying expenditure for small or medium-sized enterprises.

229. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise for the purpose of subsection (1)(b). Section 90 defines long-life asset expenditure.

Section 45: ICT expenditure incurred by small enterprises

230. This section is based mainly on section 22(3E) to (3H) of CAA 1990. It provides first-year qualifying expenditure for expenditure by small enterprises on information and communications technology (ICT).

231. Sections 47 to 49 decide whether or not expenditure is incurred by a small enterprise for the purpose of subsection (1)(b).

Section 46: General exclusions applying to sections 40, 44 and 45

232. This section brings together legislation in sections 22(6B) and (6C), 38, 50 and 81 of CAA 1990. These are general exclusions which stop expenditure being first-year qualifying expenditure.

233. The exclusions mostly relate to the type of plant or machinery bought or its use. Two which do not are worth noting:

- General exclusion 1 excludes from first-year qualifying expenditure any qualifying expenditure in the chargeable period in which there is a permanent discontinuance of a qualifying activity. This expenditure is fully relieved by a balancing allowance (or reduction in balancing charge) for the appropriate pool. Cutting out first-year allowances simplifies the route to tax relief; and
- General exclusion 8 excludes from first-year qualifying expenditure any qualifying expenditure a person is treated as incurring if they bring into use plant or machinery:
  - — previously not used for that qualifying activity; or
  - — received as a gift.

First-year allowances may already have been given for this plant or machinery when it was originally bought. But an exception to this is made for certain pre-trading expenditure on mineral exploration and access if a person is treated as having sold and bought plant or machinery.

234. It might be thought that the reference in general exclusion 7 to a “trade or business” should be to a “qualifying activity or business”. However, in the context of section 22(6C) of CAA 1990 from which this comes, the phrase “trade or business” translates into this Act so as to make neither wider nor narrower the scope of this exclusion. See *Note 14* in Annex 2.

Sections 47 to 49: Expenditure of small or medium-sized enterprises

235. These three sections are based on sections 22A and 22AA of CAA 1990. They set out how to decide if a company or other business is a small or medium-sized enterprise for the purposes of the legislation for first-year qualifying expenditure.

236. *Section 47* deals with expenditure by companies. As in other sections, the reference to the companies legislation avoids duplication in this Act and makes clear the tests are precisely the same. For ease of reference here the Companies Act 1985 provides:

Section 247: Qualification of company as small or medium-sized

"(1) A company qualifies as small or medium-sized in relation to a financial year if the qualifying conditions are met—
   (a) in the case of the company's first financial year, in that year, and
   (b) in the case of any subsequent financial year, in that year and the preceding year.

(2) A company shall be treated as qualifying as small or medium-sized in relation to a financial year—
   (a) if it so qualified in relation to the previous financial year under subsection (1) above or was treated as so qualifying under paragraph (b) below; or
   (b) if it was treated as so qualifying in relation to the previous year by virtue of paragraph (a) and the qualifying conditions are met in the year in question.

(3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

Small company	
1 Turnover	Not more than £2.8 million
2 Balance sheet total	Not more than £1.4 million
3 Number of employees	Not more than 50
Medium-sized company	
1 Turnover	Not more than £11.2 million
2 Balance sheet total	Not more than £5.6 million
3 Number of employees	Not more than 250.

237. These limits can be changed by statutory instrument. The last change was in 1992.

238. The same tests are used in the Companies (Northern Ireland) Order 1986.

239. *Subsections (2)(b)* and *(3)(b)* stop companies qualifying as small or medium-sized if they are members of a larger group. See section 49.

240. *Section 48* deals with expenditure by businesses which are not companies. The test is broadly whether the business would be a small or medium-sized company if the qualifying activity were carried on by a company. This is done by looking at whether or not a hypothetical company would be small or medium-sized.

241. *Subsection (2)* applies the section to businesses carried on by individuals and to others that are not companies and so would otherwise not be able to have first-year qualifying expenditure.

242. *Subsection (5)* sets the assumptions for the hypothetical company which is used to decide if the business is small or medium-sized. These include the assumption that every trade, business, profession or vocation carried on by the business is carried on by the business as part of that activity. This is broadly equivalent to the requirement in section 47(2)(b) that a company is not a member of a large group.

243. *Subsections (6)* and *(7)* then use the relevant companies legislation to decide if the hypothetical company is small or medium-sized.

244. *Subsections (8)* and *(9)* decide the relevant companies legislation for this purpose. They make minor changes to make clear whether the Companies Act or the Northern Ireland

legislation should be used for this purpose. The difference does not matter in practice as the legislation is very similar. See *Change 7* in Annex 1.

245. *Section 49* decides if a company is a member of a large or medium-sized group for the purposes of section 47.

246. *Subsection (4)* treats as large or medium-sized a company which is not but would be if arrangements which already exist would make it, or a successor to its trade, large or medium-sized.

247. *Subsections (5)* and *(6)* apply the relevant companies legislation.

Section 249(3) Companies Act 1985

"(3) The qualifying conditions are met by a group in a year in which it satisfies two or more of the following requirements—

Small group	
1. Aggregate turnover	Not more than £2.8 million net (or £3.36 million gross)
2. Aggregate balance sheet total	Not more than £1.4 million net (or £1.68 million gross)
3. Aggregate number of employees	Not more than 50
Medium sized group	
1. Aggregate turnover	Not more than £11.2 million net (or £13.44 million gross)
2. Aggregate balance sheet total	Not more than £5.6 million net (or £6.72 million gross)
3. Aggregate number of employees	Not more than 250.

248. These limits can be changed by statutory instrument. The last change was in 1992.

Section 50: Time when expenditure is incurred

249. This section is based on parts of section 22 of CAA 1990. It disregards the legislation which treats expenditure incurred before a qualifying activity starts as incurred in its first chargeable period (see paragraph 120 above). It is the actual date expenditure is incurred which matters for entitlement to first-year allowances.

Section 51: Disclosure of information between UK tax authorities

250. This section is based on section 22C of CAA 1990. It allows information to be exchanged by the Inland Revenue and the Department of Agriculture and Rural Development in Northern Ireland in connection with the administration of first-year allowances for expenditure by small or medium-sized enterprises for Northern Ireland purposes.

Chapter 5: Allowances and charges

Overview

251. This Chapter makes general provision for the calculation of allowances and charges under this Part. Its provisions are subject to adaptations and modifications provided in the following Chapters. They make special provisions for particular types of asset.

252. Section 52 gives the amount of first-year allowance a person is entitled to in a chargeable period if they incur first-year qualifying expenditure and own the plant or machinery. The person may then claim first-year allowances for the whole or part of first-year qualifying expenditure.

253. Sections 53 and 54 require expenditure to be pooled to decide entitlement to allowances or liability to balancing charges. Allowances may be writing-down allowances or balancing allowances. There are single asset pools, class pools and a main pool. Later Chapters define which expenditure must be allocated to a class or single asset pool. Only expenditure which is not allocated to a class or single asset pool is allocated to the main pool. If a person carries on more than one qualifying activity, there are separate pools for each activity.

254. Sections 55 and 56 decide entitlement to an allowance or liability to a charge for each pool for a chargeable period. This depends on the difference between the available qualifying expenditure (AQE) for a pool for the chargeable period and the total of any disposal receipts to be brought into account (TDR):

- if AQE exceeds TDR, the person is entitled to an allowance. The entitlement is to a writing-down allowance except in the final chargeable period of the pool when it is to a balancing allowance. The rate of writing-down allowances is 25% except for long-life assets (6%) and overseas leasing (10%);
- if TDR exceeds AQE, the person is liable to a balancing charge equal to the difference.

255. Sections 57 to 59 give the general rules for AQE and pointers to other provisions which affect it. The general rule is that AQE for a pool is the qualifying expenditure allocated to the pool for the chargeable period (section 58) plus any unrelieved qualifying expenditure brought forward from the previous chargeable period (section 59).

256. Section 60 defines "disposal receipt" and "disposal event":

- a disposal receipt is the amount of any disposal value a person must bring into account;
- a disposal event is an event of the type which requires a person to bring a disposal value into account.

257. General disposal events and disposal values are listed in section 61; there are others elsewhere.

258. Sections 63 to 65 restrict disposal values in some cases. There is a general limit equal to the qualifying expenditure incurred by the person (or in some cases a connected person). The disposal value is nil for some gifts. It is also nil if no first-year allowance is made and no qualifying expenditure is allocated to a pool (subject to additional conditions if the plant or machinery is acquired from a connected person).

259. Section 65 gives the general rules for when there is a final chargeable period for a pool.

260. Section 66 gives pointers to some other provisions dealing with disposal values.

Section 52: First-year allowances

261. This section is based mainly on section 22(1) of CAA 1990. It gives entitlement to first-year allowances.

262. *Subsection (1)* gives entitlement to first-year allowances if a person both incurs first-year qualifying expenditure in a chargeable period and owns the plant or machinery in that chargeable period.

263. *Subsection (2)* makes clear that any first-year allowance is made for the chargeable period in which the expenditure is incurred.

264. *Subsection (3)* gives the rates of first-year allowances.

265. *Subsection (4)* allows a person to claim first-year allowances for only some (including none) of their first-year qualifying expenditure. This is more direct than section 22(7) of CAA 1990. That permits a person to require that the amount of the allowance, or aggregate amount of the allowances, be reduced to an amount specified in that claim. The ability to do so helps people who might otherwise face a balancing charge in the same chargeable period. They can then add some or all of the first-year qualifying expenditure to their pool for the current chargeable period (see paragraph 295 below).

266. Section 22(7) of CAA 1990 deals with the aggregate of allowances to keep the sums simple. Section 52 gives people the option of doing that in practice by claiming for the same proportion of all first-year qualifying expenditure or of claiming for different proportions of different items of expenditure.

267. Section 22(7) does not permit a claim for reduced first-year allowances for ships. But section 30(1)(b) of CAA 1990 makes equivalent provision.

268. Section 22(7) and 30(1) require the claim to specify the reduced allowance required. Subsection (4) achieves this more directly by dealing with qualifying expenditure. See *Note 15* in Annex 2.

269. *Subsection (5)* gives signposts to other provisions which may affect first-year allowances.

Example

Assume P:

starts trading as a plumber on 6 April 2002;

prepares accounts to 5 April each year; and

buys during 2002-03 a van for £5,000 and a computer for £1,000 for use wholly and exclusively for business purposes.

P has for the year ending 5 April 2003:

£5,000 first-year qualifying expenditure under section 44 (expenditure incurred by small or medium-sized enterprises) on which P can claim allowances of £5,000 x 40% = £2,000; and

£1,000 first-year qualifying expenditure under section 45 (ICT expenditure incurred by small enterprises) on which P can claim allowances of £1,000 x 100% = £1,000.

But P does not have to claim these first-year allowances. If, for example, P has income only £1,000 greater than the personal allowance then P might decide to claim first-year allowances of £1,000 in respect of only half the expenditure on the van and none in respect of the expenditure on the computer.

Section 53: Pooling of qualifying expenditure

270. This section makes explicit that qualifying expenditure must be pooled to arrive at writing-down allowances and balancing allowances or balancing charges.

271. As noted in paragraph 98 above, Part II of CAA 1990 does not refer to pools as such. Expenditure is pooled by requiring it to be aggregated for the purposes of working out writing-down allowances, balancing allowances and charges for each trade, deemed trade or notional trade. In this Act these requirements are expressed in terms of pools for qualifying activities.

272. *Subsection (2)* requires that expenditure for separate qualifying activities must be allocated to separate pools. So a person carrying on several qualifying activities may have several main pools and class pools plus separate sets of single asset pools.

Section 54: The different kinds of pools

273. This section sets out explicitly the different types of pool. In CAA 1990 the class pools and single asset pools are notional trades. The main pool is the default for the actual trade – or the activity treated as a trade.

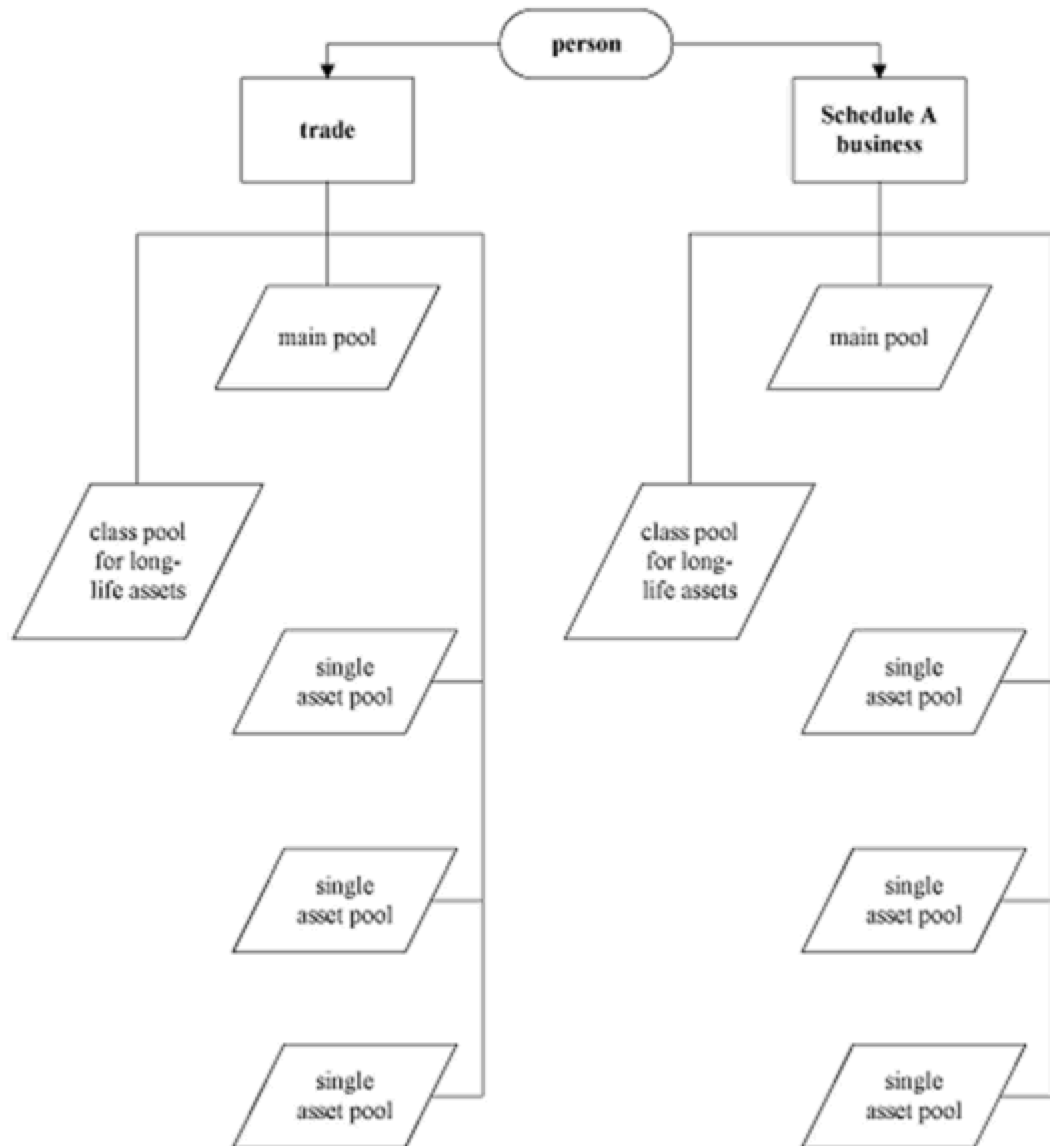
274. *Subsection (2)* provides that a single asset pool cannot contain expenditure in respect of more than one asset. CAA 1990 achieves this by creating a notional trade for expenditure on the provision of an asset separate from any other trade carried on.

275. *Subsection (3)* points to provisions which determine if qualifying expenditure has to be allocated to a single asset pool (if it is allocated to a pool).

276. *Subsection (4)* and *(5)* provide similarly for class pools.

277. *Subsection (6)* provides what is the default rule in CAA 1990. This is that expenditure can only be allocated to the main pool if it does not have to be allocated to a class or single asset pool.

Figure 2: example of requirement that expenditure relating to the different activities must not be allocated to the same pool.



Section 55: Determination of entitlement or liability

278. This section is based on section 24(2) and (5) of CAA 1990. It decides whether a pool gives rise to entitlement to an allowance or liability to a charge.

279. The amounts of available qualifying expenditure (AQE) and total of any disposal receipts (TDR) are not defined until later in this Chapter. But putting this section here lets readers see why they matter:

- if AQE is greater than TDR, they are entitled to claim an allowance; and
- if AQE is less than TDR, they are liable to a balancing charge.

Section 56: Amount of allowances and charges

280. This section is based mainly on section 24(2), (3) and (5) of CAA 1990. It decides the amount of any allowance a person is entitled to claim for a pool or the charge for which they are liable.

281. *Subsections (1)* to *(4)* deal with writing-down allowances. The amount is generally 25% of the excess of AQE over TDR, adjusted up or down if the chargeable period is more or less than a year and/or the qualifying activity is carried on for less than the whole chargeable period. For the class pool for long-life assets the rate is 6%. For the class pool for overseas leasing it is 10%.

282. *Subsection (5)* allows a person to claim less than their full entitlement to a writing-down allowance. Section 24(3) expresses this differently. It requires a person to claim the allowance and to require it to be reduced to a specified amount. But the effect is the same.

283. *Subsection (6)* provides that if TDR is greater than AQE, the balancing charge is the excess: that is TDR-AQE.

284. *Subsection (7)* provides that if:

- AQE is greater than TDR; and
- it is the final chargeable period for a pool,

then the balancing allowance is the excess: that is AQE-TDR.

285. Both a balancing charge and a balancing allowance have the effect, in colloquial terms, of "emptying the pool".

Section 57: Available qualifying expenditure

286. This section is based on section 25(1) of CAA 1990 which gives the general rule as to what is (in this Act) available qualifying expenditure. But it includes additional pointers to other provisions.

287. *Subsection (1)* gives the general rule. This is that AQE is the sum of:

- qualifying expenditure allocated to the pool in the chargeable period; and
- unrelieved qualifying expenditure brought forward from the pool from the previous chargeable period.

288. *Subsections (2)* to *(4)* point to other provisions which may affect AQE.

Section 58: Initial allocation of qualifying expenditure to pools

289. This section is based in part on section 25 of CAA 1990 and section 118(6) of FA 1994. There are also minor changes in the law. The section sets out the rules for what qualifying expenditure can be allocated to a pool and when.

290. *Subsection (1)* introduces the rules. It leaves implicit that a person is generally free to allocate or not allocate qualifying expenditure to the appropriate pool subject only to the detailed rules. (The "appropriate pool" is defined in subsection (8) as that which this Part requires.)

291. This flexibility over the allocation of qualifying expenditure is a change in the law. On close examination section 25(1) of CAA 1990 requires expenditure to be allocated to a pool in the first chargeable period it can be. This would be the chargeable period it is incurred unless first-year allowances are made. In that case it would be the next chargeable period. However the approach taken in this section is in keeping with the generally prevailing practice and maintains the flexibility taxpayers have had in practice to add qualifying expenditure in a later chargeable period (whether by design or because it was accidentally omitted in an earlier chargeable period). See *Change 8* in Annex 1.

292. *Subsection (2)* prevents qualifying expenditure being used twice.

293. *Subsection (3)* prevents qualifying expenditure being allocated to a pool before it has been incurred.

294. *Subsection (4)* prevents qualifying expenditure being allocated to a pool unless the person owns the plant or machinery at some time in the chargeable period. This is based on section 118(6) of FA 1994.

295. *Subsection (5)* means that:

- qualifying expenditure cannot be allocated to a pool for a chargeable period for which a first-year allowance is made on it – this may be only be part of the qualifying expenditure on the plant or machinery because of section 52(4); but
- the balance of qualifying expenditure less first-year allowances can then be allocated to a pool in any later chargeable period (subject to the other rules such as the person still owning the plant or machinery).

296. This incorporates minor changes in the law which make the legislation more flexible. Again, see *Change 8* in Annex 1. In summary subsection (5):

- drops the requirement in section 25(3) of CAA 1990 that taxpayers must elect by notice to the Inland Revenue if they wish to allocate first-year qualifying expenditure to a pool for the chargeable period they incur it; and
- leaves the balance of qualifying expenditure less first-year allowances made to be allocated to the appropriate pool as and when the taxpayer wishes (subject of course to the other rules).

297. *Subsection (6)* is based on section 25(5). It allows the balance of first-year qualifying expenditure less first-year allowances made to be added to the appropriate pool if there is a disposal event in the same chargeable period. That way the net cost of the plant or machinery is taken into account either by way of first-year allowances or in the pool.

298. It is up to the taxpayer to choose how much of the balance of first-year qualifying expenditure is added to the pool. Normally it will be all of the expenditure. But subsection (6) requires that at least some qualifying expenditure is allocated to the pool; and subsection (7) adds that this may even be a nil amount. This is a necessary corollary to section 64 in which this Act provides that a person does not have to bring a disposal value into account if they have allocated no expenditure to the pool. (Without the rule in subsections (6) and (7), a person might for example buy plant or machinery for £100, sell it for £90 and be left with £100 first-year allowances when the net cost is only £10.) See *Change 8* in Annex 1.

299. Section 220 makes further provision about the allocation of qualifying expenditure in relation to finance leases.

Example

Assume P incurs in 2002-03 first-year qualifying expenditure of:

£5,000 on a van but takes first-year allowances on only £2,500; and

£1,000 on a computer but takes first-year allowances on none of that expenditure. (See example on page 41 above.)

Then P can allocate to the main pool for the plumbing trade for 2002-03:

£2,500 in respect of the van; and

£1,000 in respect of the computer.

This gives available qualifying expenditure of £3,500 in total. P is entitled to claim allowances on this at 25% (see section 56). But P is not required to do so.

Section 59: Unrelieved qualifying expenditure

300. This section is based on parts of sections 24(1) and 25(1) of CAA 1990. It defines the unrelieved qualifying expenditure a person carries forward from a chargeable period.

301. *Subsection (3)* provides that no unrelieved qualifying expenditure can be carried forward from the final chargeable period of a pool. This is implicit in CAA 1990. See *Note 16* in Annex 2.

Example

Assume in the example above that P claims writing-down allowances of £3,500 x 25% = £875.

Then P carries forward £3,500 - £875 = £2,625 unrelieved qualifying expenditure to 2003-04.

P can also allocate to the pool for 2003-04 the balance of the first-year qualifying expenditure on the van on which first-year allowances were claimed (see section 58(5)): £2,500 - £1,000 = £1,500.

So assuming no other expenditure and no disposals P has for 2003-04 available qualifying expenditure (see section 57):

qualifying expenditure allocated to the pool for 2003-04	£1,500
unrelieved qualifying expenditure carried forward	£2,625
	______
available qualifying expenditure	£4,125

Section 60: Meaning of "disposal receipt" and "disposal event"

302. This section is based in part on section 24(6) of CAA 1990. It defines two terms used in this Part.

303. CAA 1990 refers to disposal values. The disposal value there is, broadly, the amount a person may have to bring into account in a pool on the occurrence of various events. But there is no simple term for those events. Nor is the disposal value always the amount actually brought into account. It may for example be limited by section 26(2) of CAA 1990 (see section 62).

304. In the interests of clarity this section defines:

- disposal receipt to mean the amount actually brought into account as a result of a disposal event – the amount which feeds into TDR. The disposal receipt may be less than the disposal value; and
- disposal event to refer to the events of the type which require a disposal value to be brought into account.

305. *Subsection (3)* is based on section 24(6) of CAA 1990. It prevents more than one disposal value being brought into account for the same expenditure on the same plant or machinery in the same pool. This makes clear what has long been the understanding of section 24 of CAA 1990 and the practice. See *Change 9* in Annex 2.

306. However, a person may be required to bring more than one disposal value into account in respect of the same plant or machinery in some circumstances. For example if they buy, sell and buy again the same plant or machinery in one chargeable period there will be two disposal values for the two separate amounts of qualifying expenditure.

307. Similarly there may be disposal values in respect of the same plant or machinery in different pools in the same chargeable period.

Example

A person starts to use plant and machinery partly for non-trade purposes. This requires a disposal value (open market value) to be brought into account. But it also creates a new pool with qualifying expenditure equal to the open market value. (See Chapter 15).

The person then sells the plant or machinery. This requires another disposal value to be brought into account. But that is in the separate, new pool.

Section 61: Disposal events and disposal values

308. This section is based on sections 24(6) and 26(1) of CAA 1990. It gives the general disposal events and the disposal values to go with them.

Example

The assumptions are as in the example for section 59 on page 47 except that P sells the van on 1 March 2004 for £3,000. This is an arm's length sale at market value. The disposal value is £3,000.

For 2003-04 P has:

available qualifying expenditure of £4,125; and

total of any disposal receipts of £3,000;

and, as AQE exceeds TDR, is entitled to writing-down allowances at 25% on £4,125 - £3,000 = £1,125

309. Item 2 in the Table provides for the market value to be found at the time of the sale. CAA 1990 is silent on this. But it is implicit. See *Note 17* in Annex 2.

310. There is a minor change. Item 5 in the Table gives a disposal value which is not in CAA 1990 in relation to the abandonment of certain plant or machinery. Section 24(6)(c)(ii) of CAA 1990 gives this disposal event. But section 26 of CAA 1990 does not give a disposal value for that specific event. In the absence of any specific disposal value within section 26(1), the disposal value is given by section 26(1)(f). It is the open market value of the plant or machinery. This is at odds with the treatment of other plant or machinery when it is demolished or possession is lost; with the treatment of plant or machinery that is dismantled or demolished as part of a decommissioning programme; and it is uncertain. Item 5 in the Table accordingly provides for the disposal value to be the insurance or other compensation received. See *Change 10* in Annex 1.

Section 62: General limit on amount of disposal value

311. This section is based on section 26(2) and (3) of CAA 1990 with a minor change. It puts a cap on disposal values.

312. *Subsection (1)* is the general rule. It is based on section 26(2) of CAA 1990. The disposal value for any plant or machinery is limited to the qualifying expenditure incurred on it. This is part of the underlying theme of this Part: plant and machinery allowances are given in total for the actual depreciation suffered on the asset. Without this provision someone who (exceptionally) sells plant or machinery for more than they paid for it would end up with an overall charge.

313. *Subsections (2)* and *(3)* modify the general rule concerning plant or machinery acquired from a connected person. They are based on section 26(3) of CAA 1990. They limit the disposal value to the greatest amount of qualifying expenditure incurred by any of

those connected persons. This rule goes hand in hand with the provisions in section 61 which allow a person to:

- sell at less than market value to a connected person who can claim capital allowances; and
- bring only the sale proceeds into account as a disposal value (rather than the open market value).

314. Without subsections (2) and (3) people could avoid balancing charges, if allowances exceeded the actual depreciation, by selling to a connected person who then sells the plant or machinery.

315. The rules are expressed in this section in terms of qualifying expenditure. Section 26(2) and (3) of CAA 1990 gives the rule in terms of capital expenditure. This is a change which is in principle generally favourable to taxpayers. It leaves out of account capital expenditure incurred by a connected person who is not carrying on a qualifying activity. It can in theory have a knock-on effect which is against a taxpayer's interests if the disposal comes within Chapter 17. This is because the benefit for the seller of a lower disposal value may then result in a lower amount of qualifying expenditure for the buyer. See *Change 11* in Annex 1.

316. Section 575 defines a "connected person".

Section 63: Cases in which disposal value is nil

317. This section is based on parts of sections 24, 67, 69, 70 and 71 of CAA 1990 and of sections 21A, 65A, 70A, 83A and 84 of ICTA. It also makes minor changes. It provides a nil disposal value for a number of disposal events.

318. *Subsection (1)* is based on section 24(6) of CAA 1990. That provides that:

"this subsection shall not require a person to bring into account the disposal value of any machinery or plant which he disposes of by way of gift in such circumstances that there is a charge to tax under Schedule E.

319. This provision has in the past caused some confusion. It was sometimes read as meaning that there was no disposal event at all. That is not right. But the absence of a disposal value still has some odd effects. For example suppose a person buys plant or machinery, claims first-year allowances and then gives it to an employee in the same chargeable period. On the basis of CAA 1990 they would not be entitled to allocate the balance of their qualifying expenditure to a pool. Subsection (1) provides a nil disposal value which allows them to do so. It also makes clearer the effect of the legislation. This could be to the disadvantage of the recipient if the gift were a transaction within Chapter 17 as it prevents the recipient from also claiming allowances. But this is thought to be unlikely in practice. See *Change 12* in Annex 1.

320. *Subsection (2)* makes similar provision for gifts to certain charities, heritage and other bodies, and educational establishments. This is based on parts of sections 83A and 84 of ICTA. They provide that section 24 of CAA 1990 does not require a disposal value to be brought into account. Subsection (2) makes a minor change, as in subsection (1), to provide a nil disposal value with similar effects. See *Change 12* in Annex 1.

321. *Subsection (2)* also omits the requirements in section 84 of ICTA that the person making the gift must have claimed plant and machinery allowances and make a claim for the relief section 84 provides. This is in principle in taxpayers' favour but is very unlikely to make any practical difference. It does however simplify the legislation for gifts to educational establishments and bring it into line with the more modern legislation in section 83A of ICTA which has neither of these requirements. See *Change 13* in Annex 1.

322. *Subsection (3)* lists the qualifying activities which get the benefit of a nil disposal value for gifts within subsection (2). This is based partly on sections 83A and 84 of ICTA. Those sections refer explicitly to trades, professions and vocations. But the effect of other provisions in ICTA is that Schedule A businesses and overseas property businesses are also included. It might be thought that other qualifying activities were also covered for the purposes of plant and machinery allowances. But there is no provision in ICTA which extends sections 83A and 84 to them. See *Note 18* in Annex 2.

323. *Subsection (4)* points to the provisions in ICTA which impose a charge on donors if they or persons connected with them receive any benefit from the gift.

324. *Subsection (5)* provides nil disposal values for expenditure of the types dealt with by section 27. CAA 1990 has the same provisions in sections 67 and 69 to 71.

Section 64: Case in which no disposal value need be brought into account

325. This section is a minor change. It provides that no disposal value need be brought into account in respect of qualifying expenditure if no first-year allowances have been made and no expenditure has been allocated to a pool.

326. There is no explicit provision in CAA 1990 equivalent to this section. It is, however, in line with practice.

327. On the basis that section 25(1) of CAA 1990 requires expenditure to be allocated automatically to a pool, there would be little need for such a provision given that the disposal value is limited to the capital expenditure incurred. But a taxpayer would appear to be required to bring a disposal value into account even if they had not appreciated they had qualifying expenditure and had made no use of it. CAA 1990 also leaves unclear what taxpayers should do if a change in the accepted meaning of plant or machinery results in their having disposal values to bring into account for what they never knew was expenditure on plant or machinery.

328. In practice the Inland Revenue have accepted that expenditure which is not added to the pool, for whatever reason, may be added for a later period provided there has not been a disposal event. This more flexible approach is followed in this Act. The Inland Revenue have also accepted that no disposal value need be brought into account if no first-year allowances have been made and none of the expenditure has been allocated to a pool.

329. Subsection (1) puts this on a clearer statutory basis. It provides that no disposal value need be brought into account if no expenditure is allocated to a pool (which, when read with section 58(6), means also that no first-year allowances are made). See *Change 14* in Annex 1.

330. *Subsections (2)* to *(4)* are consequential on the change in subsection (1). They require a person ("C") who has qualifying expenditure for plant or machinery acquired from a connected person to bring into account a disposal value if:

- C allocates any qualifying expenditure to a pool (or gets first-year allowances); or
- any of the connected persons in the transaction or train of transactions before C brings into account a disposal value.

331. The first is no more than the general rule. The second prevents the minor change in subsection (1) being used by connected persons to escape bringing into account disposal values on plant or machinery for which allowances are claimed. See again *Change 14* in Annex 1.

332. Section 575 defines a "connected person".

Section 65: The final chargeable period

333. This section is based on the several provisions throughout Part II of CAA 1990 which deal with pools. There are also two minor changes. It defines the final chargeable period for pools. A final chargeable period means there may be entitlement to a balancing allowance (see section 56).

334. *Subsection (1)* means there is a final chargeable period for the main pool for the qualifying activity of special leasing when the special leasing ends. This is not clear in section 61 of CAA 1990 but is what one would expect from the underlying approach in Part II of CAA 1990. It avoids anomalies such as a pool with no end; and allowances which cannot be used against any income whatsoever. See *Change 15* in Annex 1.

335. *Subsection (2)* provides a final chargeable period for a single asset pool when there is a disposal event. But this is subject to the additional provisions pointed to in subsection (3). This is based on parts of sections 24, 31, 34, 37, 79 and 80 of CAA 1990. They provide for the notional trades (pools here) to be permanently discontinued. Most use a common form of words:

    "without prejudice to section 24(6)(c)(i) to (iii), the [notional] trade is permanently discontinued when the [plant or machinery] begins to be used wholly or partly for purposes other than those of the actual trade

336. Section 24(6)(c)(i) to (iii) of CAA 1990 lists disposal events and has been taken to mean the pool ends with a final chargeable period when such an event occurs. Subsection (2) provides for this. See *Change 15* in Annex 1.

Section 66: List of provisions outside this Chapter about disposal values

337. This section sets out provisions elsewhere in Part 2 about disposal values.

Chapter 6: Hire-purchase etc. and plant or machinery provided by lessee

Overview

338. This Chapter makes special provision for expenditure on plant or machinery under a hire-purchase or similar contract which a person does not own. It also deals with expenditure by lessees who are required, under the terms of a lease, to provide plant or machinery which they do not own.

339. Section 67 treats a person entitled to the benefit of plant or machinery under a hire-purchase or similar contract as owning it. It also treats the person as having incurred all the expenditure under the contract when they bring the plant or machinery into use.

340. Section 68 provides disposal values when a person ceases to be entitled to the benefit of a contract and so is treated as ceasing to own it. The disposal value depends on whether or not the plant or machinery has been brought into use.

341. Section 69 excludes fixtures (as defined in Chapter 14) from section 67.

342. Section 70 deals with the special circumstances mentioned in paragraph 338. A lessee who is required to provide plant or machinery under the terms of a lease but does not own it is, subject to certain conditions, treated as owning it. The lessor is then, in certain circumstances, subsequently required to bring a disposal value into account.

Background

343. A person buying plant or machinery under a hire-purchase or similar contract does not own it. So they cannot meet the general conditions for allowances under this Part in section 11.

344. Legislation to enable a person to get plant and machinery allowances for expenditure under hire-purchase contracts was introduced (by FA 1957) at the same time as the general rule that plant or machinery had to belong to a person as a result of the expenditure for them to be entitled to plant and machinery allowances.

Section 67: Plant or machinery treated as owned by person entitled to benefit of contract, etc.

345. This section is based mainly on section 60(1) and (4) of CAA 1990. It treats a person who meets the conditions in the section as owning the plant or machinery. This means they meet the general condition in section 11(4)(b) (that the person owns the plant or machinery).

346. *Subsection (3)* treats the person as incurring all the capital expenditure under the contract when the plant or machinery is brought into use for the qualifying activity. *Subsection (4)* treats the person as ceasing to own the plant or machinery when they cease to be entitled to the benefit of the contract if they do not then own it. These have implications for the disposal values given in the next section.

347. This section does not apply to expenditure on fixtures (see section 69) and subsection (3) does not apply to expenditure for finance leasing (see section 229(3)).

Section 68: Disposal value on cessation of notional ownership

348. This section is based on section 60(2) of CAA 1990. It provides the disposal value when a person ceases to be entitled to the benefit of a hire-purchase or similar contract. There is a minor change.

349. Section 60(2) of CAA 1990 makes specific provision for the disposal value when a person ceases to be entitled to the benefit of a contract after bringing the plant or machinery into use for their qualifying activity. *Subsection (2)* gives the amount.

350. CAA 1990 makes no specific provision for the disposal value when a person ceases to be entitled to the benefit of a contract before the plant or machinery is brought into use. *Subsection (3)* fills this gap. The disposal value is the same as in subsection (2) except that, as the person was not treated as having incurred all the remaining capital expenditure under the contract, there is no need to take that amount away as a disposal value. See *Change 16* in Annex 1.

351. *Subsection (5)* refers to section 229. That makes sure the disposal value in subsection (3) here does not disadvantage a person to whom a contract is assigned in a transaction which is within Chapter 17.

Section 69: Hire-purchase etc. and fixtures

352. This section is based on section 60A of CAA 1990. It excludes expenditure on fixtures from the special provisions for hire-purchase and similar contracts in section 67.

Section 70: Plant or machinery provided by lessee

353. This section is based mainly on section 61(4) and (8) of CAA 1990. It provides for the rare circumstances in which a lessee has to provide plant or machinery under the terms of a lease but does not own it. There is a minor change.

354. If the section applies:

- the lessee is treated as owning the plant or machinery; but
- the lessee is not required to bring a disposal value into account when the lease ends.

355. The latter is an exception to the usual rule in CAA 1990 (and in this Act). Usually cessation of ownership (or deemed ownership) is a disposal event. But in the unusual

circumstances dealt with by this section it is the lessor who is required, if the plant or machinery continues in use until the lease ends, to bring a disposal value into account. That is certainly the accepted practice. Subsections (3) to (5) provide that. In doing so they fill in some gaps in section 60(4) of CAA 1990. See *Change 17* in Annex 1.

Chapter 7: Computer software

Overview

356. This Chapter makes additional provision for computer software:

- computer software is treated as plant for the purposes of Part 2 (section 71); and
- the grant of rights to software on which qualifying expenditure is incurred may require a disposal value to be brought into account for which there are additional rules (sections 72 and 73).

Section 71: Software and rights to software

357. This section is based on section 67A of CAA 1990. It treats software and rights to software as plant. This means expenditure on software can qualify for plant and machinery allowances.

Section 72: Disposal values

358. This section is based on sections 24(6A) and 26(1)(ea), (eb) and (ec) of CAA 1990. It makes additional provision (over and above those in Chapter 5) for disposal values for computer software.

359. *Subsections (1)* and *(2)* are based on section 24(6A) of CAA 1990. They introduce as an additional disposal event for computer software the grant of a right to use or otherwise deal with software. This does not affect how computer software is subject to the ordinary disposal events. See section 61.

360. *Subsection (3)* is based on section 26(1)(ea), (eb) and (ec) of CAA 1990. It deals with disposal values for the grant of a right to use or otherwise deal with computer software.

Section 73: Limit on disposal values

361. This section is based on section 26(2AA). It deals with the limit on disposal values for computer software and rights to use or otherwise deal in computer software.

362. The general limit on disposal values is in section 62. This section modifies that to take account of the fact that there may have been earlier disposal values brought into account.

Chapter 8: Cars, etc.

Overview

363. This Chapter makes special provisions for cars (and motorbikes) costing over £12,000. It includes definitions which are used for other sections in Part 2.

364. The Chapter:

- requires a single asset pool for expenditure over £12,000 on a car (other than a qualifying hire car) (section 74);
- restricts writing-down allowances to a maximum of £3,000 a year (section 75);
- restricts writing-down allowances further if part of the expenditure is met by another person, the car is use only partly for the qualifying activity, or there is a depreciation subsidy (sections 76 to 78);

- makes additional provision for the disposal value if:
  - — a person ceases to own a car in a transaction within Chapter 17; or
  - — an employee or office-holder has claimed capital allowances for some years and for other years used the administrative fixed profit car scheme instead.

365. Sections 81 and 82 define "car" and "qualifying hire car" for the purposes not just of this Chapter but for Part 2 generally.

Section 74: Single asset pool

366. This section is based on section 34(1) and (2) of CAA 1990. It deals with cars costing in excess of £12,000. Qualifying expenditure on them must be allocated to a single asset pool (if allocated to a pool at all). Section 54 introduces single asset pools.

Section 75: General limit on amount of writing-down allowance

367. This section is based on section 34(3) of CAA 1990. It limits the writing-down allowance on a car above the £12,000 cost threshold to £3,000 a year.

368. *Subsection (3)* lists other provisions of this Chapter that may limit further the amount of the writing-down allowance.

Section 76: Limit where part of expenditure met by another person

369. This section is based on section 34(3)(b) of CAA 1990. It restricts allowances if part of the expenditure on the car is met by another person or persons.

370. The limit of £3,000 on writing-down allowances is restricted further for both the recipient of the contribution and the contributors (if they are entitled to plant and machinery allowances). Each is limited to a proportion of the £3,000 limit according to how much of the expenditure on the car they met. The total writing-down allowances due to all parties cannot exceed £3,000 a year.

371. Subsections (3) and (4), unlike section 35(1) of CAA 1990, do not create special pools for contributions to expenditure on expensive cars. This is not required because of the way Part 11 handles contributions. See *Note 19* in Annex 2, and the related *Change 60* in Annex 1.

Section 77: Car used partly for purposes other than those of qualifying activity

372. This section is based on section 34(5) of CAA 1990. It deals with cars that are partly used for purposes other than those of the qualifying activity.

373. There is no disposal event when a car within this Chapter begins to be used in this way. So the single asset pool under this Chapter takes the place of the single asset pool which would otherwise be required by Chapter 15. But the rules in this section are similar to those in Chapter 15 as regards the just and reasonable reduction to any allowances and charges.

374. Subsection (1) provides that no balancing allowance or charge arises when the car begins to be used partly for purposes other than those of the qualifying activity. See *Note 20* in Annex 2.

375. Subsection (4) deals with calculation of unrelieved qualifying expenditure carried forward. In saying that any reduction of a writing-down allowance under this section is to be disregarded, this subsection goes further than section 34(5) of CAA 1990. See *Note 21* in Annex 2

Section 78: Effects of partial depreciation subsidy

376. This section is based on section 34(5) of CAA 1990. It deals with partial depreciation subsidies made in respect of cars over the cost threshold. Much as with section 77, it takes the place of Chapter 16 for cars, but otherwise has similar effect.

377. Subsection (3) deals with calculation of unrelieved qualifying expenditure carried forward. In saying that any reduction of a writing-down allowance under this section is to be disregarded, it goes further than section 34(5) of CAA 1990. See *Note 21* in Annex 2.

Section 79: Cases where Chapter 17 (anti-avoidance) applies

378. This section is based on section 34(4) of CAA 1990. It deals with cases in which a car is disposed of in a transaction within Chapter 17. The intention when this legislation was introduced was to prevent artificial acceleration of allowances for cars over the cost threshold by disposal events between connected persons.

Section 80: Vehicles provided for purposes of employment or office

379. This section is based on section 27(2A) to (2E) of CAA 1990. It gives plant and machinery allowances to employees and office-holders on a car or cycle they use partly for "business travel". There is a minor change.

380. The general rule in section 36 is that employees and office-holders have qualifying expenditure only for plant or machinery "necessarily provided for use in the performance of the duties". This rule is relaxed to include expenditure on cars and cycles partly for use as in *subsection (2)* – what is generally known as "business use". This includes a minor change to align the legislation for capital allowances with that for expenses in ICTA. See *Change 18* in Annex 1.

381. *Subsection (3)* limits the balancing allowance an employee or office-holder is entitled to if they have:

- in some years claimed capital allowances on a car or cycle; and
- in other years made use instead of the administrative arrangements (for example the fixed profit car scheme) which give tax relief without claims.

Section 81: Extended meaning of "car"

382. This section is based on section 36(1)(a) and (b) of CAA 1990. It defines "car" for the purposes of this Part.

383. Other references to car include sections 46 (general exclusion 2 from first-year qualifying expenditure), 84 (short-life assets treatment ruled out) and 96 (cars are not long-life assets).

Section 82: Qualifying hire cars

384. This section is based on section 36 of CAA 1990. It defines "qualifying hire cars". These are not subject to the provisions of this Chapter.

Chapter 9: Short-life assets

Overview

385. This Chapter provides single asset pools for some expenditure. A person elects for expenditure to be allocated to a pool of this type. Doing so means a disposal event within, broadly, four years gives rise to a balancing allowance (or charge). This gives capital allowances for the net cost of plant or machinery with a life of less than about four years earlier than if the expenditure were allocated to the main pool.

386. Section 83 defines short-life asset and section 84 gives a Table of cases in which treatment as a short-life asset is ruled out.

387. Section 85 deals with the election.

388. Section 86 sets up the single asset pool. Section 87 provides special pooling rules for leased assets.

389. Section 88 prevents avoidance by sale at under value and section 89 deals with the sale of a short-life asset to a connected person.

Section 83: Meaning of "short-life asset"

390. This section is based on section 37(1) of CAA 1990. It introduces the term "short-life asset" and gives its meaning.

Section 84: Cases in which short-life asset treatment is ruled out

391. This section is based on section 38 of CAA 1990. It rules out short-life asset treatment for some types of expenditure on plant or machinery.

Section 85: Election for short-life asset treatment: procedure

392. This section is based on section 37(2) of CAA 1990. It deals with the elections for short-life asset treatment.

Section 86: Short-life asset pool

393. This section is based on section 37(3) and (5) of CAA 1990. It requires single asset pools for short-life assets. It defines the new term "four-year cut-off". This is used in this Chapter only.

Section 87: Short-life assets provided for leasing

394. This section is based on section 37(6) of CAA 1990. It deals with leased assets that are used other than for a qualifying purpose.

395. Section 84 permits assets provided for leasing to be short-life assets if they:

- are cars hired to disabled persons; or
- will be used only for qualifying purposes in the designated period.

396. If the plant or machinery starts to be used for what is not a qualifying purpose, the short-life asset pool ends. The expenditure left in the single asset pool goes to the main pool.

Section 88: Sales at under-value

397. This section is based on section 37(10) of CAA 1990. It provides a general rule that disposals of short-life assets at less than market value have a disposal value of their market value. There are exceptions if the disposal is one in which there is a charge to tax under Schedule E or an election is made under section 89.

Section 89: Disposal to connected person

398. This section is based on section 37(8) and (9) of CAA 1990. It allows connected persons to elect for a different treatment if they transfer a short-life asset between them. They can treat it like a sale at a price equal to the amount of the qualifying expenditure left in the pool. "Connected person" is defined in section 575. Both parties must make the election.

Chapter 10: Long-life assets

Overview

399. This Chapter provides rules for long-life assets. Expenditure on long-life assets must be allocated to a separate class pool. It is subject to a special rate of writing-down allowances of 6%.

400. Section 90 defines "long-life asset expenditure". Section 91 defines "long-life asset". Section 92 provides for this Chapter to apply to only part of the capital expenditure on plant or machinery.

401. Sections 93 to 96 provide that some fixtures, ships, railway assets and cars are not long-life assets.

402. Sections 97 to 100 provide, very broadly, that this Chapter does not apply to expenditure on long-life assets up to £100,000. Some types of expenditure are excluded from this.

403. Section 101 requires a class pool for long-life assets unless the expenditure is allocated to a single asset pool.

404. Section 102 limits writing-down allowances for long-life asset expenditure to 6% a year.

405. Sections 103 and 104 provide anti-avoidance rules. Section 103 provides that long-life assets do not cease to be treated as such when they are second-hand. Section 104 prevents avoidance by artificial acceleration of allowances.

Background

406. Legislation for long-life assets was introduced by Schedule 14 to FA 1997. That inserted Chapter IVA of CAA 1990. At the time of the Budget in 1996 it was stated that the intention was to bring the tax treatment of long-life assets more closely into line with normal accountancy practice.

407. The new rules applied only to assets bought under contracts made on or after Budget day in 1996. Section 38H of CAA 1990 provided the necessary legislation to exclude expenditure incurred before 26 November 1996 or expenditure incurred before 1 January 2001 on contracts entered into before 26 November 1996. The effect of section 38H is maintained in paragraph 20 of Schedule 3 to this Act.

Section 90: Long-life asset expenditure

408. This section is based on section 38A(1) of CAA 1990. It defines "long-life asset expenditure".

Section 91: Meaning of "long-life asset"

409. This section is based on section 38A(2) and (3) of CAA 1990. It defines "long-life asset". A long-life asset is an asset with a useful economic life of 25 years or more when new.

Section 92: Application of Chapter to part of expenditure

410. This section is based on section 38A(4) and (5) of CAA 1990. It deals with circumstances in which this Chapter only applies to part of the capital expenditure on plant or machinery. If that happens then the expenditure within this Chapter is treated as expenditure on a separate asset from the expenditure outside it. If necessary, apportionments are made between that part to which this Chapter applies and that part to which it does not.

Section 93: Fixtures etc.

411. This section is based on section 38B(1) of CAA 1990. It excludes expenditure on fixtures in certain types of building from being long-life asset expenditure.

412. The types of buildings are broadly those which do not usually qualify for industrial buildings allowances. So the long-life asset rules in general only apply to fixtures in industrial buildings.

Section 94: Ships

413. This section is based on section 38B(3) of CAA 1990. It excludes expenditure on ships incurred before 1 January 2011 from being long-life asset expenditure.

414. *Subsection (2)* defines "ship" for these purposes. It covers cruise liners as they are not ships designed primarily for sport or recreation.

415. *Subsection (3)* takes the definitions of "offshore installation" and "controlled waters" from the Mineral Workings (Offshore Installations) Act 1971. The text of these definitions is given in the explanatory note on section 153.

Section 95: Railway assets

416. This section is based on section 38B(4) of CAA 1990. It excludes expenditure on railway assets incurred before 1 January 2011 and used for a railway business from being long-life asset expenditure.

417. *Subsections (2)* and *(3)* define "railway asset" and "railway business".

418. *Subsection (4)* extends the exemption to trains used to travel between the UK and another country.

419. *Subsections (5)* gives "railway" the same meaning as in section 81(2) of the Railways Act 1993. The text of this definition is:

"(2) Where it is stated for the purposes of any provision of this Part that railway has its wider meaning, "railway" shall be taken, for the purposes of that provision, to mean:

a railway;

a tramway; or

a transport system which uses another mode of guided transport but which is not a trolley vehicle system, and cognate expressions shall be construed accordingly.

(3) In paragraphs (a) to (c) of subsection (2) above "guided transport, "railway", "tramway" and "trolley vehicle system" have the meaning given by section 67(1) of the Transport and Works Act 1992.

420. Section 67(1) of the Transport and Works Act 1992 gives the following further definitions:

""guided transport system" means transport by vehicles guided by means external to the vehicles (whether or not the vehicles are also capable of being operated in some other way)

"railway" means a system of transport employing parallel rails which-

provide support and guidance for vehicles carried on flanged wheels

form a track which either is of a gauge of at least 350 millimetres or crosses a carriageway (whether or not on the same level)

"tramway" means a system of transport used wholly or mainly for the carriage of passengers and employing parallel rails which-

provide support and guidance for vehicles carried on flanged wheels, and

are laid wholly or mainly along a street or in any other place to which the public has access (including a place to which the public only has access on making a payment)

"trolley vehicle system" means a system of transport by vehicles constructed or adapted for use on roads without rails under electric power transmitted to them by overhead wires (whether or not there is in addition a source of power on board the vehicles).

421. *Subsection (6)* gives other terms the same meaning as in the Railways Act 1993. These definitions are:

""goods" includes mail, parcels, animals, plants and any other creature, substance or thing capable of being transported, but does not include passengers;

"light maintenance depot" means any land or other property which is normally used for or in connection with the provision of light maintenance services, whether or not it is also used for other purposes;

"station" means any land or other property which consists of premises used as, or for the purposes of, or otherwise in connection with, a railway passenger station or railway passenger terminal (including any approaches, forecourt, cycle store or car park), whether or not the land or other property is, or the premises are, also used for other purposes;

"track" means any land or other property comprising the permanent way of any railway, taken together with the ballast, sleepers and metals laid thereon, whether or not the land or other property is also used for other purposes; and any reference to track includes a reference to–

any level crossings, bridges, viaducts, tunnels, culverts, retaining walls, or other structures used or to be used for the support of, or otherwise in connection with, track; and

any walls, fences or other structures bounding the railway or bounding an adjacent or adjoining property;

Section 96: Cars

422. This section is based on section 38B(2) of CAA 1990. It excludes expenditure on cars from being long-life asset expenditure.

423. The definition of a car in section 82 means expenditure on cars (and motorbikes) is excluded from this Chapter whether or not the car would be within Chapter 8.

Sections 97 to 100: Monetary limit

424. These four sections are based on sections 38C and 38D of CAA 1990. They provide a *de minimis* limit. Expenditure is not usually long-life asset expenditure if a person's total expenditure on long-life assets is less than £100,000 a year. If the limit is exceeded all the relevant expenditure is long-life asset expenditure.

425. Section 98 means the limit is available to:

- individuals and partnerships within subsections (1) and (2); and
- any company, for the purposes of corporation tax.

426. There is a minor change in section 98(1)(a). It refers to any qualifying activity carried on by an individual. Section 38C(3)(a) of CAA 1990 only refers to trades and professions. See *Change 19* in Annex 1.

427. Section 99 gives the £100,000 limit. It also:

- increases or reduces the limit if a chargeable period is more or less than a year; and
- reduces the limit if a company has associated companies. This reduction is done in the same way that the limit for small companies relief is reduced in section 13 of ICTA.

428. Section 100 sets out when the limit is exceeded. It also provides that all the expenditure on an item of plant or machinery is looked at to see if the limit is exceeded – not just the expenditure which is incurred (or treated as incurred) in a particular chargeable period.

Section 101: Long-life asset pool

429. This section is based on section 38E(1) and (2) of CAA 1990. It requires a separate pool for long-life asset expenditure. If the expenditure does not have to be allocated to a single asset pool this is the class pool for long-life asset expenditure. A separate pool is necessary to apply the 6% rate of writing-down allowances for long-life assets.

430. The rule in section 38E(2)(c) of CAA 1990 which provides that the class pool for long-life assets only ends when the trade ends is in section 65(1).

431. *Subsection (2)* is drafted on the basis that a qualifying activity of special leasing can have a long-life asset pool. See *Note 22* in Annex 2.

Section 102: Writing-down allowances at 6%

432. This section is based on section 38F of CAA 1990. It provides writing-down allowances at 6% a year for long-life asset expenditure. This rate applies to the class pool for long-life assets and to any long-life asset expenditure in a single asset pool.

433. *Subsection (2)* is drafted on the basis that a qualifying activity of special leasing can have a long-life asset pool. See *Note 22* in Annex 2. The 6% rate can also apply to a contributor's single asset pool. See *Note 23* in Annex 2.

Section 103: Later claims

434. This section is based on section 38F(3) and (4) of CAA 1990. It provides that plant or machinery which has been treated as a long-life asset by one person must be treated as a long-life asset by anyone who subsequently incurs qualifying expenditure on it. This broadly means second-hand assets are treated in the same way as they were when new.

435. There is an exception to this. This applies for expenditure that is excluded from being long-life asset expenditure simply by sections 93 to 96. For example, an asset could be a railway asset to a new owner but not the former owner. In such a situation, the new owner's expenditure would be long-life asset expenditure.

Section 104: Disposal value of long-life assets

436. This section is based on section 38G of CAA 1990. It prevents tax avoidance arrangements designed to accelerate allowances.

437. Subsection (1)(d) refers to "tax advantage". This is defined in section 577(4).

438. Subsection (3) deals with the "notional written-down value". This is handled in a different way from section 38G(2) and (3). See *Note 24* in Annex 2.

Chapter 11: Overseas leasing

Overview

439. This Chapter reduces or prohibits allowances on qualifying expenditure if:

- the plant or machinery is leased during the designated period to a person who is not resident in the UK;
- that person does not use the plant or machinery exclusively for earning profits chargeable to UK tax; and
- the leasing is not protected leasing.

440. This expenditure is referred to in this commentary as "affected qualifying expenditure".

441. Sections 105 and 106 define "leasing", "overseas leasing", "protected leasing" and "designated period".

442. Section 107 allocates affected qualifying expenditure to a class pool (the overseas leasing pool) unless it is long-life asset expenditure or expenditure which must be put into a single asset pool.

443. Section 108 modifies the general rules for disposal values if plant or machinery in the overseas leasing pool is disposed of to a connected person. In those circumstances the section also affects the expenditure that the person acquiring the plant or machinery is treated as incurring.

444. Section 109 provides writing-down allowances at 10% a year (instead of 25%) for pools containing affected qualifying expenditure (other than long-life asset expenditure). So this rate applies both to the overseas leasing pool and to any single asset pools containing such expenditure.

445. Section 110 prohibits allowances on affected qualifying expenditure if the plant or machinery is leased under certain types of lease.

446. Sections 111 to 113 recover any excess allowances from earlier chargeable periods if it only becomes clear in a later chargeable period that the expenditure is affected qualifying expenditure. The amount recovered broadly leaves taxpayers where they would have been if allowances had always been given at 10% on the affected qualifying expenditure. There are special provisions to do this for ships.

447. Sections 114 to 115 recover any excess allowances made for earlier chargeable periods if, in a later chargeable period, circumstances are such that allowances are prohibited. The amount recovered again broadly puts taxpayers back where they would have been if allowances had been prohibited from the start.

448. Sections 116 and 117 provide for certain modifications to these rules if the plant or machinery is let to joint lessees.

449. Sections 118 to 120 deal with certificates and notices that are required in certain cases. Sections 121 to 126 define some terms used in this Chapter.

Background

450. The material in this Chapter is based on Chapter V of Part II of CAA 1990.

451. Sections 45, 47 and 49 of CAA 1990 (together with sections 39(2)(a) and (8)(a), 40(4)(a) and (4)(b)(ii)) deal with "old expenditure". They are not rewritten in this Act. See *Note 77* in Annex 1.

Section 105: "Leasing", "overseas leasing" etc.

452. This section is based on sections 42(1), 50(1) to (3A) and 83(2A) of CAA 1990. It defines some of the main terms used in this Chapter.

453. *Subsection (1)(a)* refers to a "ship or aircraft on charter" whereas section 50(2) of CAA 1990 refers to a "ship on charter". This does not affect the law. See *Note 25* in Annex 2.

454. *Subsection (3)(a)'s* reference to "profits chargeable to tax" uses a different form of words from that in sections 42(1)(b) and 50(3A) of CAA 1990. This does not affect the law. See *Note 26* in Annex 2.

Section 106: The designated period

455. This section is based on sections 40(4) and (5) and 50(3) of CAA 1990. It defines the period during which this Chapter can affect qualifying expenditure. Typically that period ends when the person who incurs qualifying expenditure disposes of the plant or machinery or, if earlier, ten years after the person first uses the plant or machinery. But the rules are modified in special cases: for example, if plant or machinery is transferred between connected persons.

Section 107: The overseas leasing pool

456. This section is based on section 41(1)(a) and (6) and part of section 41(2) of CAA 1990. It requires certain affected qualifying expenditure to be put in a class pool ("the overseas leasing pool").

457. *Subsection (2)* takes a simpler approach to special leasing than section 42(2)(e) of CAA 1990. It leaves expenditure on plant or machinery for special leasing to be dealt with like expenditure on plant or machinery for other qualifying activities. See *Note 22* in Annex 2.

Section 108: Effect of disposal to connected person on overseas leasing pool

458. This section is based on section 41(5) of CAA 1990. It prevents disposals to a connected person being used to get a balancing allowance in respect of an overseas leasing pool. It does so by modifying the disposal value that has to be brought into account in the overseas leasing pool. The person acquiring the plant or machinery is treated as having incurred expenditure equal to the disposal value so as to get the right answer in terms of total allowances over the period of their combined ownership.

Section 109: Writing-down allowances at 10%

459. This section is based on sections 42(1) and (2) and 24(2)(a)(ii) of CAA 1990. It replaces the usual 25% rate of writing-down allowances by a 10% rate. This 10% rate applies to:

- the overseas leasing pool; and
- any single asset pool if the plant or machinery is used at any time in the designated period for overseas leasing which is not protected leasing (except for long-life assets for which the normal rate for that of 6% still applies).

460. *Subsection (3)* differs in some respects from section 42(2) of CAA 1990. The subsection:

- applies the 10% rate to all single asset pools including those for expenditure on plant or machinery used partly for the purposes of the qualifying activity and partly for other purposes. These pools are not mentioned in section 42(2) of CAA 1990. See *Change 20* in Annex 1;
- does not mention special leasing. Section 42(2)(e) of CAA 1990 needs to provide for the 10% rate to apply to special leasing. But the simpler approach in section 107

(see paragraph 457 above) means the 10% rate does still apply in such cases. See *Note 22* in Annex 2; and

- covers single asset pools generally. This includes single asset pools for contributions. So it is not necessary to mention them explicitly as in section 42(2)(d) of CAA 1990. See *Note 23* in Annex 2.

Section 110: Cases where allowances are prohibited

461. This section is based on section 42(3) of CAA 1990. It prohibits allowances in certain circumstances.

Section 111: Excess allowances: standard recovery mechanism

462. This section is based on section 46(1) to (4) and (8) of CAA 1990. It recovers allowances if:

- expenditure is allocated to a pool with writing-down allowances at 25%; but
- it becomes clear in a later chargeable period that this Chapter applies to that expenditure.

463. The section broadly withdraws the difference between:

- any first-year allowances plus writing-down allowances at 25%; and
- allowances at 10%.

464. It does so by imposing a balancing charge and requiring a disposal value. In broad terms:

- the balancing allowance recovers the excess of allowances made over what would have been made at 10%; and
- the disposal value takes out of the pool the residue of qualifying expenditure in the pool on which future allowances would otherwise be made at 25%.

465. But in the next chargeable period it allocates to an appropriate pool the total of the allowances withdrawn and the expenditure taken out of the original pool. The net effect of this is broadly that the expenditure is still relieved in full but at a slower rate – as it would have been if the 10% rate had applied from the outset.

Section 112: Excess allowances: connected persons

466. This section is based on section 46(5), (6) and (8) of CAA 1990. It makes two modifications to section 111 for transactions between connected persons.

467. The first modification deals with the possibility that a transaction gives rise to a balancing allowance to one of the connected persons. This would not otherwise be taken into account in section 111 which (without this modification) looks only at first-year allowances and normal writing-down allowances. With this modification any balancing allowance is taken into account when withdrawing excess allowances.

468. The second modifies section 111 if a transfer was not subject to what are known as the "step in shoes" provisions for capital allowances. These are provisions such as sections 561 in this Act and section 343 of ICTA (see paragraph 1936 below) which broadly allow a successor to take on the entitlement to allowances and liability to balancing charges of a predecessor.

469. The modification:

- identifies the expenditure in relation to which section 111 applies. This is necessary as each of the connected parties may have incurred different amounts of expenditure

on the plant or machinery. The amount used is that of the first connected person to have taken an allowance in relation to the plant or machinery; then

- provides that later transactions between the connected parties are ignored; and finally
- provides for a just and reasonable adjustment to the formulae in section 111 if a balancing adjustment has been made to any of the connected persons in respect of the plant or machinery.

Section 113: Special provision for ships

470. This section is based on section 46(7) and (8) of CAA 1990. It deals with the case in which expenditure on a ship has been allocated to a single ship pool by section 127.

471. This section gives priority to sections 111 and 112 over the single ship pool provisions. It ends the single ship pool treatment if, during the designated period, the ship is used for overseas leasing which is not protected leasing (see section 132). It adds any postponed allowances in respect of the expenditure, if they have not been taken by the first chargeable period of such overseas leasing, to the same pool as the amount in section 111(3). The postponed allowances cannot be claimed under the single ship provisions from the first chargeable period of such overseas leasing.

Section 114: Prohibited allowances: standard recovery mechanisms

472. This section is based on section 42(4), (5) and (9) of CAA 1990. It deals with the general case in which allowances are taken on expenditure but, in a later chargeable period, it becomes clear that section 110 applies so that no allowances are available in respect of that expenditure.

473. This section broadly withdraws any allowances by means of a balancing charge and a disposal value. The allowance withdrawn takes account of any allowances withdrawn by section 111 so there is no double counting.

474. *Subsection (2)(b)* provides that a disposal value is to be brought into account to remove from the pool the qualifying expenditure on which no allowances can be made. There is no explicit provision for this in CAA 1990. See *Note 27* in Annex 2.

Section 115: Prohibited allowances: connected persons

475. This section is based on section 42(6) and (7) of CAA 1990. It modifies section 114 if there have been transactions between connected parties which have not resulted in "step in shoes" treatment for capital allowances. It is similar to section 112.

Section 116: Mitigation of regime

Section 117: Recovery of allowances in case of joint lessees

476. These sections are based on sections 43 and 44 of CAA 1990. They deal with expenditure on plant or machinery if at some time in the designated period:

- the plant or machinery is leased to joint lessees who use it for the purposes of qualifying activities but not for leasing;
- one of the lessees is not resident in the UK and does not use the plant or machinery exclusively to earn profits chargeable to UK tax; and
- the leasing is not protected leasing.

477. These sections are likely to affect relatively few people. They are broadly meant to cater for unusual cases in which this Chapter might otherwise lead to results not intended.

478. An example might be a letting of machinery to a partnership between a person in the United Kingdom and a person overseas for use in a construction contract carried on by them outside the United Kingdom. If the partnership is on a 50/50 basis the owner of the plant or machinery might get allowances on 50% of the expenditure under the normal rules. The other 50% would be subject to sections 109 (with writing-down allowances at 10%) and 110 (allowances prohibited). The actual split of the expenditure is based on the extent to which it appears that, over a certain period, the profits of the lessees will be chargeable to UK tax. Without these sections the 10% rate of allowances or the prohibition on allowances would apply to the whole of the owner's expenditure.

479. Because the expenditure which is split is in fact on a single item of plant or machinery there are consequential provisions dealing with the corresponding split of disposal values on a disposal of the plant or machinery.

480. These sections only allow part of the expenditure to be treated for the duration of that lease as being on plant or machinery which is not used for overseas leasing. So if the plant or machinery is used at some other time during the designated period for overseas leasing which is not protected leasing the whole of the expenditure will be subject to the 10% rate or the prohibition on allowances and these sections will be of little or no relevance.

481. If:

- the joint lease continues at the end of the designated period; and
- the profits of the joint lessees chargeable to United Kingdom tax are less than originally anticipated,

there is a provision for downwards adjustment of the part of the expenditure subject to the normal provisions.

482. And if at some time during the joint lease none of the lessees uses the plant or machinery to earn profits chargeable to United Kingdom tax, all of the expenditure becomes subject to the 10% rate or the prohibition on allowances.

483. *Section 117(1)* includes the words "the plant or machinery (or as the case may be)" which do not appear towards the end of section 44(2) of CAA 1990. Without these words, section 44(2) is not entirely consistent. See *Note 29* in Annex 2.

484. Section 43(5) of CAA 1990 is not necessary now and has not been rewritten. See *Note 28* in Annex 2.

Sections 118 to 120: Certificate and notices

485. These sections are based on sections 44(2) and 48 of CAA 1990.

Section 121: Meaning of "short-term leasing"

486. This section is based on section 40(1) to (3) of CAA 1990. It defines when plant or machinery is used for short-term leasing.

Section 122: Short-term leasing by buyer, lessee, etc.

487. This section is based on parts of sections 39(1), (3), (4) and (10) and 40(5) of CAA 1990. The common theme is that the plant or machinery is being used for short-term leasing by any of the various persons mentioned in this section. This is the first of five sections dealing with when plant or machinery is used for a qualifying purpose.

Section 123: Ships and aircraft

488. This section is based on section 39(6) to (8) of CAA 1990. It gives additional circumstances in which a ship or aircraft is used for a qualifying purpose.

Section 124: Transport containers

489. This section is based on section 39(9) of CAA 1990. It gives additional circumstances in which a transport container is used for a qualifying purpose.

Section 125: Other qualifying purposes

490. This section is based on sections 39(1), (2), (5) and (10) and 40(5) of CAA 1990. It treats plant or machinery as used for a qualifying purpose when the plant or machinery is used by certain persons otherwise than for leasing.

Section 126: Minor definitions

491. This section is based on section 50(3) to (4A) of CAA 1990.

Chapter 12: Ships

Overview

492. This Chapter contains provisions relating to plant and machinery allowances and balancing charges arising in respect of expenditure on ships. Within the Chapter there are two main sets of provisions. These provide entitlement to:

- postpone first-year and writing-down allowances arising on ships; and
- defer balancing charges arising on the disposal of certain ships.

493. The first set of provisions deals with pooling of expenditure and postponement of allowances. These provisions allow first-year and writing-down allowances to be "stockpiled" and taken in subsequent chargeable periods. In order to achieve this:

- sections 127 to 129 deal with the allocation of expenditure to single asset pools ("single ship pools"), the circumstances in which expenditure on ships must not be allocated to a single ship pool, and an election for expenditure to be allocated to a different pool;
- sections 130 to 131 allow taxpayers to postpone allowances for single ship pools and to take them in future chargeable periods; and
- sections 132 to 133 deal with disposal events in respect of single ship pools.

494. The second set of provisions deal with deferment of balancing charges:

- section 134 introduces the deferment rules;
- sections 135 to 139 set out when, how and how much of a balancing charge can be deferred;
- sections 140 to 145 set out how to attribute new expenditure on ships with deferred balancing charges. They include rules attributing older balancing charges to older expenditure, the procedure for varying an attribution and the rules which apply if some of the conditions for attribution cease to be met;
- sections 146 to 150 identify what counts as expenditure on new shipping; and
- sections 151 to 154 identify ships which qualify for the deferment rules;
- sections 155 and 156 allow the deferment rules to operate across a change in the person carrying on the qualifying activity and give "connected persons" a special, wider meaning for the purposes of the deferment rules.

495. Sections 157 and 158 provide for the Chapter to be given effect and apply the provisions of ICTA which decide if companies are members of the same group.

Background

496. Legislation which allowed the postponement of plant and machinery allowances on ships was first introduced in FA 1965. Subsequent changes to plant and machinery allowances made similar provision. The current approach stems mainly from FA 1985.

497. The deferment rules were introduced by sections 94 to 98 of FA 1995 to deal with cases in which:

- a balancing charge arises on the disposal of a ship; and
- a replacement ship is not acquired until a subsequent chargeable period.

498. The deferment rules let a person defer the balancing charge if expenditure (equal to or greater than the amount deferred) is incurred on a replacement ship within six years of the disposal.

Section 127: Single ship pool

499. This section is based on parts of section 31(1) and (2) of CAA 1990. It requires expenditure on ships to be allocated to a single asset pool – called a "single ship pool" – subject to the two exceptions in *subsection (2)*.

500. *Subsection (3)* defines the appropriate non-ship pool. This replaces the term "actual trade" which is used in CAA 1990. See *Note 30* in Annex 2.

Section 128: Expenditure which is not to be allocated to single ship pool

501. This section is based on parts of section 31(1) and (11) of CAA 1990. It provides that expenditure must not be allocated to a single ship pool if the ship is provided for leasing unless the ship meets the conditions in *subsection (1)(a)* and *(b)*.

Section 129: Election to use the appropriate non-ship pool

502. This section is based on section 33 of CAA 1990. It allows taxpayers to opt out of the single ship pool rules in respect of any expenditure on ships. It includes a minor change.

503. *Subsection (1)* provides for an election to do this. CAA 1990 requires taxpayers to give notice for this rather than to elect. By requiring an election, this Act gives taxpayers the benefit of section 42 of TMA 1970 and Schedule 18 to FA 1998. See *Change 21* in Annex 1.

504. This section has nothing for the following provisions in section 33 of CAA 1990 which are unnecessary for this Act:

- section 33(1) – see *Notes 32* and *33*in Annex 2;
- section 33(2) – this is unnecessary given the way this Act deals with pools in Chapter 5; and
- section 33(3)(a) – see *Note 31* in Annex 2.

505. Section 577 defines "notice". Section 576 gives the meaning of "Inland Revenue".

Section 130: Notice postponing first-year or writing-down allowance

506. This section is based on sections 30(1) and (1A) and 31(3) and (3A) of CAA 1990. It allows taxpayers to postpone first-year allowances arising on the provision of ships and writing-down allowances for single ship pools.

507. Section 577 defines "notice". Section 576 gives the meaning of "Inland Revenue".

Section 131: Effect of postponement

508. This section is based on sections 30(2) and (4) and 31(4), (5) and (10) of CAA 1990. It deals with the mechanics of postponing an allowance.

509. *Subsection (1)(b)* provides that the postponement of an allowance does not affect the calculation of the available qualifying expenditure in any chargeable period.

510. *Subsections (2)* and *(3)* provide that the total amount postponed may be taken as allowances in subsequent chargeable periods.

511. *Subsection (4)* makes it clear that the total allowances so claimed may not exceed the total amount postponed.

512. *Subsection (5)* makes it clear that any allowances made (but previously postponed) do not affect the calculation of the unrelieved qualifying expenditure in section 59.

513. *Subsection (6)* ensures that any subsequent claim for an allowance that has previously been postponed does not affect the calculation of writing-down allowances in that subsequent chargeable period.

514. *Subsection (7)* provides that postponed allowances (that have not subsequently been taken) are not treated as amounts carried forward for the purposes of section 403ZB(2) of ICTA. Section 31(10) of CAA 1990 also refers to sections 383(5)(d) and 388(7) of ICTA. However, these references were spent following the repeal of section 383 and of part of section 388(7) by FA 1994.

515. Sections 30(5) and 31(6) of CAA 1990 have not been rewritten. See *Note 34* in Annex 2. That also explains the reference in subsection (1)(b) of this section to "the allowance" in place of "the whole allowance" in section 30(2)(b) of CAA 1990.

Section 132: Disposal events and single ship pool

516. This section is based on parts of sections 31(2) and (11), 31(7), 33(5)(b) and 40(4) of CAA 1990. It:

- gives an additional disposal event for single ship pools; and
- provides special rules for any disposal event which occurs.

517. *Subsection (2)* provides the special rules dealing with all disposal events in relation to a single ship pool. These rules are necessary as the postponement rules are not intended to give rise to balancing allowances or charges on the disposal of a ship.

518. In CAA 1990, a disposal value is brought into account in the notional trade (which is how the single ship pool is established). However, any balancing allowance or charge is not given effect in the normal way. The amount is instead allocated to the shipowner's actual trade as if it were qualifying expenditure (in the sense used in CAA 1990) or a disposal value. This section is more direct. If there is a disposal event in respect of a single ship pool, any available qualifying expenditure is allocated to the appropriate non-ship pool. It is in that pool that any disposal value is brought into account. The end result under these two different methods is the same. See *Note 35* in Annex 2.

519. *Subsection (3)* makes it clear that a disposal event is dealt with in the same way if there has been an election under section 129.

520. There is nothing in this section equivalent to section 31(8) of CAA 1990. That cannot affect tax liabilities in chargeable periods covered by this Act.

Section 133: Ship not used

521. This section is based on section 32(1) of CAA 1990. It withdraws any writing-down allowances made or postponed for a single ship pool if the ship ceases to be owned without being used for the purposes of the qualifying activity.

522. Relief for expenditure on the ship is not lost. Subsection (3) allocates an amount equal to the withdrawn allowances to the appropriate non-ship pool.

523. *Subsection (4)* makes it clear that this section does not apply as an alternative to section 132. Both sections could apply to a single event.

524. Section 32(2) of CAA 1990 is not rewritten in this Act as it merely ensures that definitions applying in section 31 also apply to section 32(1).

Section 134: Deferment of balancing charges: introduction

525. This section provides an introduction to the deferment rules in sections 135 to 156.

Sections 135 and 136: Claims and conditions for deferment

526. These sections are based on parts of sections 33A(1) and (2) and 33F(1) and (2). They provide the conditions that need to be met if a person is to defer a balancing charge.

527. This Act has nothing corresponding to:

- section 33F(3) of CAA 1990. That provides for claims to be made under the deferment rules on or after 31 May 1996; and
- section 33A(2)(b) of CAA 1990. That provides that there can be no deferment if any of the limits on the amount deferred is nil. It is unnecessary as the deferment of nil would have no effect.

Section 137: Effect of deferment

528. This section is based on part of section 33A(2) of CAA 1990. It provides the mechanism for giving effect to the deferment. It reduces or (if the full balancing charge is deferred) cancels out the effect of the balancing charge by allocating the amount deferred to the appropriate non-ship pool. This is because the balancing charge from the disposal of the ship leads to a disposal value in the appropriate non-ship pool. See paragraph 518 above and section 132.

Section 138: Limit on amount deferred

529. This section is based on part of section 33A(2), (3) and (6) of CAA 1990. It provides the upper limits on the amount of any balancing charge that may be deferred. There is a minor change.

530. *Subsection (1)(a)* provides that the amount deferred must not exceed the balancing charge which would arise in the appropriate non-ship pool if the claim for deferment had not been made. In CAA 1990, this limit is expressed in terms of what would be the balancing charge for the shipowner's actual trade ignoring balancing charges from the notional trades (in this Act, pools) provided by sections 41(2), 79(5) and 80(5).

531. This subsection is more direct. Subsection (1)(a) also ensures that balancing charges arising in the "appropriate non-ship pool" applicable to a ship may not affect a claim to defer a balancing charge arising in a different pool. See *Change 22* in Annex 1.

532. *Subsection (1)(b)* provides that the deferred amount is limited to the balancing charge actually attributable to the ship. This amount is quantified in section 139. This ensures that other disposal events in the appropriate non-ship pool do not have the effect of increasing the amount available for deferment.

533. *Subsection (1)(c)* ensures that the amount of a deferment claim is limited to the expenditure on new shipping that will be incurred in the six years from the disposal event. This expenditure must be incurred either by:

- the shipowner; or
- if the shipowner is a company, a member of the same group as the shipowner.

534. *Subsection (1)(d)* provides that the amount of the deferment may not exceed the shipowner's profits or income from the qualifying activity in the relevant chargeable period. This ensures that a deferment claim may not create a loss for the chargeable period in which the balancing charge arises.

535. *Subsection (2)* provides that for the purposes of subsection (1)(d):

- other deferments for the chargeable period are taken into account; and
- a deferment takes precedence over the provisions dealing with the carry-forward of trading losses.

Example

Suppose P has a shipping trade. During the year ending 30 June 2001 P has a taxable profit of £340,000. That figure includes a balancing charge of £500,000 arising on the disposal of a qualifying ship. P also has trading losses of £209,000 available to carry forward at 1 July 2000.

If no claim for deferment is made, P's net profit for the year ending 30 June 2001 is:

Actual profit	£340,000
Less:	
Loss brought forward	£209,000
	________
Taxable profit	£131,000
	________

P would have no further losses available to carry forward to the chargeable period for the year ending 30 June 2002.

If P is expecting to incur further expenditure on new shipping within six years of the disposal, P will be entitled to defer the balancing charge arising in the year ending 30 June 2001.

Under subsection (1)(a) the amount qualifying for deferment may not exceed the balancing charge arising (£500,000). Under subsection (1)(d), the deferred amount must also be no more than P's profit for the year ending 30 June 2001 (£340,000). In accordance with subsection (2), the losses brought forward are ignored for this.

Suppose P defers £340,000. The balancing charge is effectively reduced by this amount, giving rise to a nil profit in the year ending 30 June 2001. P's losses of £209,000 will be carried forward to the year ending 30 June 2002.

Section 139: Amount taken into account in respect of old ship

536. This section is based on section 33B of CAA 1990. It determines the amount of any balancing charge that is deemed to relate to the ship. It is one of the provisions that ensure that a shipowner may only defer a balancing charge arising from the disposal of a qualifying ship.

537. It is relatively easy to identify the balancing charge arising on the disposal of the ship if:

- all of the expenditure on the provision of a ship is allocated to a single ship pool; and
- no expenditure is then allocated from the single ship pool to the appropriate non-ship pool.

It is just the excess of the disposal value over the available qualifying expenditure after any allowances. *Subsection (2)* provides this – "amount A".

538. The same cannot be done if some or all of the expenditure on the ship is allocated to the appropriate non-ship pool. It is in the nature of pooling that it is impossible to say how much of any allowance relates to one bit of expenditure and how much to another. Some assumptions have to be made. *Subsections (3)* and *(4)* do this. They provide "amount B" – what would have been the balancing charge if:

- all the expenditure on the ship were allocated to the appropriate pool;
- no other expenditure had been allocated to that pool; and
- writing-down allowances had been made in full.

539. *Subsection (5)* caters for a person who defers a balancing charge and then later makes an election to allocate expenditure to the non-ship pool. They can do this because section 129 allows up to two years to make the election. It substitutes amount B in place of amount A. Any adjustments to assessments can then be made if necessary (see section 157).

Section 140: Notice attributing deferred amounts to new expenditure

540. This section is based on section 33A(5), (5A), (6) and (8) of CAA 1990. It provides the basic conditions that need to be met for a deferred amount to be attributed to expenditure on new shipping.

541. If a deferred amount is not attributed to expenditure on new shipping, then section 144 provides that it ceases to qualify for deferment.

542. *Subsection (1)* provides that the shipowner must give a notice to the Inland Revenue attributing a deferred amount to the new expenditure.

543. *Subsection (2)* makes it clear that an attribution matches a deferred amount with an equal amount of new expenditure.

544. *Subsection (3)* ensures that the rule in subsection (1) is subject to the following two subsections and to the "first-in first-out" rule in section 141.

545. *Subsection (4)* requires the expenditure to be incurred in the six years beginning with the relevant disposal event. For example, if the balancing charge arising relates to the disposal of a ship on 29 November 2001, the expenditure on new shipping must be incurred by 28 November 2007. The expenditure must be incurred by the shipowner or a company within the same group.

546. *Subsection (5)* ensures that the total attributed to new expenditure may not exceed the amount of the new expenditure.

547. Section 577 defines "notice".

Section 141: Deferred amounts attributed to earlier expenditure first

548. This section is based on section 33D(6) of CAA 1990. It requires a deferred amount to be attributed to the first item of expenditure on new shipping that is incurred in the six-year period. If the first item of expenditure is less than the deferred amount, then

the excess is carried forward to the next item, and so on. This means that shipowners cannot generally choose how to attribute deferred amounts.

549. There is a minor change. *Subsection (2)(b)* goes wider than CAA 1990 by providing for the case in which two ships are disposed of simultaneously. See *Change 23* in Annex 1.

Section 142: Variation of attribution

550. This section is based on section 33F(4) and (4A) of CAA 1990. It lets a shipowner vary an attribution. This gives the shipowner an element of choice as to which ship a deferred amount is attributed. That can be of benefit to taxpayers if two (or more) ships are acquired simultaneously.

Example

A has deferred a balancing charge of £1m arising in respect of the disposal of a ship on 20 August 2001. On 7 October 2002, A acquires two new ships, *S1* and *S2* for £500,000 and £750,000 respectively. A initially attributes £500,000 of the deferred amount to both of the new ships.

On 24 March 2003, A sells *S1* for £500,000. As a result of the original claim for deferment, this sale will give rise to a further balancing charge of £500,000. A does not expect to incur any further expenditure on shipping. As a result, A will not be able to defer any of this amount. However, provided A does so within the time limits provided by this section, A can vary the original attribution to maximise the amount attributed to *S2* (in other words to £750,000 leaving only £250,000 attributed to *S1*).

Section 143: Effect of attribution

551. This section is based on section 33C of CAA 1990. It gives effect to an attribution as a disposal value in the single ship pool.

552. This may seem a roundabout way of doing things. The shipowner has in effect already had tax relief for the expenditure on the new ship against the earlier balancing charge. So it might be thought that all that is needed is to provide that some or all of the expenditure on the new ship is not qualifying expenditure. Although that would adequately reduce future plant and machinery allowances it could also cause problems. For example, when the new ship is sold, section 62 might mean there was no disposal value. The approach here, which in effect:

- lets the shipowner add the expenditure on the new ship to a pool but
- requires a disposal value in the pool,

fits in better with the wider scheme of Part 2.

Section 144: Amounts which cease to be attributable

553. This section is based on section 33A(4) of CAA 1990. It deals with cases in which deferred amounts cease to qualify for deferment. For example, if an amount is deferred, it may become clear (either during the six-year period or at its conclusion) that there will not be sufficient expenditure in the period to which the deferred amount may be attributed. In such cases the amount qualifying for deferment is retrospectively reduced as appropriate.

Section 145: Requirement to notify where no entitlement to defer amounts

554. This section is based on section 33F(5) and (6) of CAA 1990. It requires the shipowner to notify the Inland Revenue on ceasing to be entitled to a deferment.

555. The shipowner has to notify the Inland Revenue no later than three months from the end of the relevant chargeable period. Failure to do so makes the shipowner liable to a penalty under section 98(5) of TMA 1970.

556. This will almost invariably give rise to a change in the shipowner's taxable profits in earlier chargeable periods. *Subsection (4)* allows assessments to be made outside the normal time limits.

557. Section 33F(5) has as one of its conditions that "a claim for deferment has been made". However, the context makes it clear that the provision is only relevant if a deferment has actually been made (rather than simply claimed). As a result this section refers to an amount having actually been deferred.

558. Section 576 gives the meaning of "Inland Revenue". Section 577 defines "notice".

Section 146: Basic meaning of expenditure on new shipping

559. This section is based on section 33D(1) of CAA 1990. It provides the basic conditions for expenditure to qualify as expenditure on new shipping. Sections 147 to 150 give further rules.

560. *Subsection (3)(a)* requires that the expenditure is incurred wholly and exclusively for the purposes of a qualifying activity carried on by the person incurring the expenditure. This stops expenditure from qualifying if, for example, the ship is used only partly for purposes of the qualifying activity of the person incurring the expenditure.

561. *Subsection (3)(b)* requires that when the expenditure is incurred, it must appear that the ship will be used for a qualifying activity (as a qualifying ship) and will continue to do so for at least three years. This is to prevent the attribution of deferments to ships that are not intended to be used as qualifying ships. Section 33D(1)(a) does not include the words "when the expenditure is incurred". But they are implicit in CAA 1990.

562. *Subsection (3)(c)* requires that the expenditure on the ship is allocated to a single ship pool. This stops expenditure on, for example, some ships for leasing from qualifying for the deferment rules.

Section 147: Exclusions: ship previously owned

563. This is the first of four sections with further conditions for expenditure to qualify for attribution. It is based on section 33D(4) and (5) of CAA 1990. It stops expenditure qualifying for attribution if, broadly speaking, a person, A, buys a ship:

- within six years of previously owning it; or
- which had been owned in that six-year period by a person who is connected with A at any time between:
  - — the disposal event; and
  - — A becoming the owner of the ship.

564. "Connected person" is defined in section 187.

Example

A plc defers a balancing charge arising on the disposal of a ship on 6 February 2003. On 23 April 2005 A plc purchases a qualifying ship, *S*. *S* was owned by A plc's subsidiary company, E Limited between 15 May 2001 and 6 June 2002. At all other times, *S* was owned by unconnected third parties.

Subsection (1)(a) does not prevent A plc from attributing the deferred balancing charge to the expenditure on *S* because the company has not previously owned the ship.

Subsection (1)(b), however, determines that the deferred amount may not be attributed to the expenditure on *S*. This applies because E Limited has owned the ship during the six years before S plc acquired the ship (on 23 April 2005) and A plc is connected with E Limited at a material time (in other words at some time between 6 February 2003 and 23 April 2005).

Section 148: Exclusions: object to secure deferment

565. This section is based on part of section 33D(4) of CAA 1990. It is an anti-avoidance provision which stops expenditure qualifying for attribution if deferment of a balancing charge was the object or one of the main objects of the transaction (or transactions) by which the ship was provided.

Section 149: Exclusions: later events

566. This section is based on section 33D(2) and (3) of CAA 1990. It means expenditure ceases to qualify for attribution if any of the events listed in subsection (1) occurs. This stops expenditure for ships, which only temporarily satisfy the conditions, being attributed to deferred balancing charges.

567. *Subsection (1)(a)* provides that the ship has to be a “qualifying ship” for the first three years after it is first brought into use. This term is defined in sections 151 to 154. The 3-year period stops early if the ship begins to be owned by an unconnected third party. CAA 1990 contains the words “without having been so brought into use”. This Act does not as the meaning is covered by the use in *subsection (2)(a)* of the words “first” and “if earlier”.

568. *Subsection (1)(b)* requires that the expenditure on the ship is not allocated to the appropriate non-ship pool. This only applies to the expenditure to which a deferred balancing charge is attributed. If the total expenditure on the provision of a ship exceeds the deferred amount, the excess can be allocated to the appropriate non-ship pool.

569. *Subsection (1)(c)* requires that the expenditure is not on a ship for overseas leasing which is not protected leasing.

Section 150: Exclusions where expenditure not incurred by shipowner

570. This section is based on section 33D(2A) and (2B) of CAA 1990. It stops expenditure incurred by a member of the same group of companies qualifying as expenditure on new shipping if the company:

- ceases to own the ship before it is used for its qualifying activity; or
- is required to bring in a disposal value in respect of the ship within the first three years of the ship being used,

unless it is because the ship is lost or irreparably damaged.

571. *Subsection (4)* has the same effect if the company and the shipowner cease to be members of the same group within three years of the ship being used by the company. But any changes in the group are ignored if they happen after the ship is lost or irreparably damaged.

Section 151: Basic meaning of qualifying ship

572. This section is based on section 33E(1) of CAA 1990. It provides the basic conditions for a ship to qualify for the deferment rules. That is:

- for a balancing charge on the ship to be deferred; or
- for expenditure on the ship to be attributed to a deferred charge.

Section 152: Ships under 100 tons

573. This section is based on section 33E(2) of CAA 1990. It relaxes the rule that requires a qualifying ship to have a gross registered tonnage of 100 tons or more. The relaxation applies if the disposal event giving rise to the balancing charge is or results from the total loss of a ship or the irreparable damage to it.

Section 153: Ships which are not qualifying ships

574. This section is based on section 33E(3) and (4) of CAA 1990. It provides that certain kinds of ships are not qualifying ships.

575. *Subsection (1)* excludes from the meaning of "qualifying ship" ships of a kind generally used for sport or recreation. Passenger ships and cruise liners are not treated as falling within this exclusion and may therefore be considered as qualifying ships.

576. *Subsection (3)* gives "offshore installations" and "controlled waters" the same meaning as in the Mineral Workings (Offshore Installations) Act 1971. The relevant definitions are reproduced below.

Regulation 3(1) of the Offshore Installations and Pipeline Works (Management and Administration) Regulations 1995 (SI 1995/738)

"An *offshore installation* is "a structure which is, or is to be, or has been used, while standing or stationed in relevant waters, or on the foreshore or other land intermittently covered with water-

(a) for the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well:

(b) for the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;

(c) for the conveyance of things by means of a pipe; or

(d) mainly for the provision of accommodation for persons who work on or from a structure falling within any if the provisions of this paragraph,

and which is not an excepted structure [under paragraph 2]".

Section 12 of the Mineral Workings (Offshore Installations) Act 1971

"Controlled waters are:

"tidal waters and parts of the sea in or adjacent to Great Britain up to the seaward limits of territorial waters; and

any area designated by order under section 1(7) of the Continental Shelf Act 1964".

Section 154: Further registration requirement

577. This section is based on part of section 33E(5) to (9) of CAA 1990. It provides that a qualifying ship must generally be registered on a register of shipping within the British Isles, a British colony or the European Economic Area.

578. This additional registration requirement does not need to be met:

- during the first three months that the ship is used; or
- more than three years after the ship is first used.

579. If the ship is no longer owned by the person incurring expenditure on it (or a connected person) at some time during the 3-year period, then the registration requirement does not need to be met from that time.

Section 155: Change in the persons carrying on the qualifying activity

580. This section is based on sections 33D(7) and 33F(7) of CAA 1990. It allows the deferment rules to operate when a trade is transferred in certain circumstances so a successor to the trade can incur the expenditure on new shipping and attribute it to the predecessor's deferred balancing charge.

581. There is a minor change. The section treats expenditure incurred by successors as that of the shipowner. This goes slightly further than CAA 1990. But in practice the effect is only that a successor to a trade is entitled to give notice of a variation of attribution of expenditure under section 142. See *Change 24* in Annex 1.

582. *Subsection (2)* applies only for the deferment rules. In CAA 1990, section 33D(7) applies for the whole of Part II. But this is in fact not a difference. See *Note 36* in Annex 2.

> The circumstances in which section 113 of ICTA may apply are, very briefly, if there is a change in the persons carrying on a trade, profession or vocation, but at least one person carrying on the activity before the change continues to carry it on afterwards.
>
> The circumstances in which section 343 of ICTA may apply are, again very briefly, if a trade is transferred between companies in common ownership.

Section 156: Connected persons

583. This section is based on section 33D(8) and part of section 33E(8) of CAA 1990. It provides an extended meaning of "connected person" for the purposes of the deferment rules. This caters for the way section 155 allows the deferment rules to operate across the transfer of a trade.

584. Section 33E(8)(a) uses the word "connected" without any specified definition. But from the context it is implicit that the word has the meaning given by section 839 of ICTA.

Section 157: Adjustment of assessments etc.

585. This section is based on sections 30(3) and 31(9) and part of section 33F(6) of CAA 1990. It provides for the making of adjustments to assessments as necessary to give effect to the rules in the Chapter.

Section 158: Members of same group

586. This section is based on sections 33D(2B)(b) and 33E(2)(b) and part of section 33A(8) of CAA 1990. It defines when two companies are "members of the same group".

Chapter 13: Provisions affecting mining and oil industries

Overview

587. This Chapter brings together rules which apply only to the mining and oil industries.

588. Section 159 states the meaning of "mineral extraction trade".

589. Section 160 treats expenditure incurred for mineral exploration and access in connection with a mineral extraction trade as incurred for the purposes of the trade.

590. Section 161 deals with relief for pre-trading expenditure on mineral exploration and access.

591. Section 162 sets up a separate qualifying activity for a ring fence trade.

592. Section 163 defines "abandonment expenditure" for the purposes of the next two sections.

593. Section 164 gives special relief for abandonment expenditure in ring fence trades.

594. Section 165 provides relief for abandonment expenditure in the three years following the cessation of trade.

595. Section 166 is an anti-avoidance provision applying if an interest in an oil field is transferred.

596. Sections 167 to 171 deal with production sharing contracts. Section 167 sets out the general conditions which apply. Section 168 treats expenditure incurred on plant or machinery by a contractor under a production sharing contract as being incurred on plant or machinery. Section 169 provides a similar rule for expenditure incurred by "participators" in production sharing contracts. Section 170 deals with the acquisition of an interest in a production sharing contract by a participator. Section 171 deals with disposal values on the cessation of ownership under subsection (2) of any of the previous three sections.

Background

597. Sections 160 and 161 work together to give relief for pre-trading expenditure on mineral exploration and access. If the expenditure is connected with an existing trade, section 160 will apply. If it is not connected to an existing trade then section 161 will apply.

598. On 7 August 2000 the Inland Revenue announced that the government had agreed to bring forward new legislation to give relief for the re-use of oil rigs, pipelines and other North Sea Oil installations. This is expected to form part of Finance Act 2001 and to become incorporated into this Chapter.

Section 159: Meaning of "mineral extraction trade" etc.

599. This section is based on the defined terms in section 83(1) of CAA 1990. They define "mineral extraction trade" and "mineral exploration and access" by reference to the definitions in Part 5. See section 394(2) for the meaning of "mineral extraction trade" and section 396 for "mineral exploration and access".

Section 160: Expenditure treated as incurred for purposes of mineral extraction trade

600. This section is based on section 83(6) of CAA 1990. It provides for expenditure on the provision of plant or machinery for mineral exploration and access which is connected with a mineral extraction trade to be treated as for the purposes of the trade.

601. This relaxes the ordinary rule in *section 11* that expenditure has to be for the purposes of the qualifying activity.

Section 161: Pre-trading expenditure on mineral exploration and access

602. This section is based on section 63 of CAA 1990. It allows pre-trading expenditure on plant or machinery used for mineral exploration and access to be brought into the pool at cost when the trade commences.

603. There is a minor change in *subsection (4)(a)*. In section 63(1)(a) of CAA 1990 there is no explicit requirement that the expenditure has to be *capital* expenditure on the provision of plant or machinery. See *Change 25* in Annex 1.

604. This section is referred to in section 13(7). This is because this section overrides the general rule for plant and machinery which is used before it is brought into use for a qualifying activity. The general rule in section 13(3) and (4) would operate to bring the plant or machinery into the pool at the lower of cost or market value.

605. R&D allowances (see Part 6) are available for some types of pre-trading expenditure on mineral exploration and access. Oil and gas exploration and appraisal is treated as "research and development" by section 437(2)(b).

Section 162: Ring fence trade a separate qualifying activity

606. This section is based on section 492(1) of ICTA and section 62A(2) of CAA 1990. It creates a separate qualifying activity for ring fenced trades.

Section 163: Meaning of "abandonment expenditure"

607. This section is based on section 62A(1). It introduces and defines the term "abandonment expenditure" for the purposes of sections 164 and 165.

608. Subsection (5) refers to definitions in the Oil Taxation Act 1975 and the Petroleum Act 1998. These are set out below.

Section 12 of OTA 1975 provides:

> ""oil field" shall be construed in accordance with Schedule 1 to this Act.

Schedule 1 to OTA 1975 provides:

> " for the purposes of this Part of this Act an oil field is any area which the appropriate authority may determine to be an oil field, being an area of which every part is, or is part of, a licensed area.

Section 29(1) of the Petroleum Act 1998 provides:

> " an "abandonment programme" is… a programme setting out the measures proposed to be taken in connection with the abandonment of an offshore installation or submarine pipeline.

Section 44 of the Petroleum Act 1998 provides:

"(1) In this Part of this Act, "offshore installation" means any installation which is or has been maintained, or is intended to be established, for the carrying on of any activity to which subsection (2) applies.

(2) This subsection applies to any activity mentioned in subsection (3) which is carried on from, by means of or on an installation which is maintained in the water, or on the foreshore or other land intermittently covered with water, and is not connected with dry land by a permanent structure providing access at all times and for all purposes.

(3) The activities referred to in subsection (2) are—

- (a) the exploitation, or the exploration with a view to exploitation, of mineral resources in or under the shore or bed of relevant waters;
- (b) the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;
- (c) the conveyance of things by means of a pipe, or system of pipes, constructed or placed on, in or under the shore or bed of relevant waters; and
- (d) the provision of accommodation for persons who work on or from an installation which is or has been maintained, or is intended to be established, for the carrying on of an activity falling within paragraph (a), (b) or (c) or this paragraph.

(4) In this Part of this Act, "relevant waters" means—

- (a) tidal waters and parts of the sea in or adjacent to the United Kingdom up to the seaward limits of the territorial sea;
- (b) waters in an area designated under section 1(7) of the Continental Shelf Act 1964; and

(c) such inland waters as may for the time being be specified for the purposes of this paragraph by Order in Council;

but Her Majesty may by Order in Council provide that, in such cases and subject to such exceptions and modifications as may be prescribed by the Order, this Part of this Act shall have effect as if—

(i) any reference in this Part of this Act to relevant waters included a reference to waters in any area specified under section 10(8); and

(ii) in relation to an installation which is or has been maintained, or is intended to be established, in relevant waters, any reference in subsection (3) to relevant waters included a reference to waters in a foreign sector of the continental shelf which are adjacent to such waters.

(5) For the purposes of this section—

"inland waters" means waters within the United Kingdom other than tidal waters and parts of the sea;

"installation" includes—

(a) any floating structure or device maintained on a station by whatever means; and

(b) in such cases and subject to such exceptions as may be prescribed by Order in Council, any apparatus or works which are by virtue of section 26 to be treated as associated with a pipe or system of pipes for the purposes of Part III of this Act,

but, subject to paragraph (b), does not include any part of a pipeline within the meaning of that section;

"modifications" includes additions, omissions and alterations.

(6) The fact that an installation has been maintained for the carrying on of an activity falling within subsection (3) shall be disregarded for the purposes of this section if, since it was so maintained, the installation—

(a) has been outside relevant waters or, where it was so maintained in a part of a foreign sector of the continental shelf adjacent to those waters, the area consisting of those waters and that part; or

(b) has been maintained for the carrying on of an activity not falling within that subsection.

(7) Any statutory instrument containing an Order under subsection (4) shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Section 45 of the Petroleum Act 1998 provides:

" "Submarine pipeline" means a pipeline within the meaning of section 26 which is in, under or over waters in the territorial sea adjacent to the United Kingdom; or an area designated under section 1(7) of the Continental Shelf Act 1964.

Section 26 of the Petroleum Act 1998 provides:

"(1) Except where the context otherwise requires, in this Part of this Act "pipeline" means a pipe or system of pipes (excluding a drain or sewer) for the conveyance of any thing, together with any apparatus and works associated with such a pipe or system.

(2) For the purposes of this Part of this Act the apparatus and works associated with such a pipe or system are—

(a) any apparatus for inducing or facilitating the flow of any thing through, or through a part of, the pipe or system;

(b) any apparatus for treating or cooling any thing which is to flow through, or through part of, the pipe or system;

(c) valves, valve chambers and similar works which are annexed to, or incorporated in the course of, the pipe or system;

(d) apparatus for supplying energy for the operation of any apparatus or works mentioned in paragraphs (a) to (c);

(e) apparatus for the transmission of information for the operation of the pipe or system;

(f) apparatus for the cathodic protection of the pipe or system; and

(g) any structure used or to be used solely for the support of a part of the pipe or system.

(3) The Secretary of State may by order provide that a part of a pipeline specified in the order shall be treated for the purposes of this Part of this Act, except this subsection, as a pipeline.

Section 164: Abandonment expenditure incurred before cessation of ring fence trade

609. This section is based on section 62A of CAA 1990. It provides rules for a special allowance for abandonment expenditure.

610. To qualify for the allowance, an election must be made (which is irrevocable).

611. The special allowance is given in the chargeable period of abandonment, effectively as a 100% capital allowance.

612. *Section 165*, provides a similar relief for expenditure in the three years following cessation of the ring fence trade.

Section 165: Abandonment expenditure within 3 years of ceasing ring fence trade

613. This section is based on section 62B of CAA 1990. It deals with abandonment expenditure after the cessation of the ring fence trade.

614. If the ring fence trade has ceased, then the relief provided by section 164 will not be available.

615. There is no election needed but the expenditure must be incurred within three years of the cessation of the ring fence trade. Section 5 determines when capital expenditure is incurred.

616. If the expenditure qualifies then there is no special allowance as such but the additional expenditure is added to the pool for the last period of trading. That will increase the balancing allowance or reduce the balancing charge so the net result is the same.

Section 166: Transfers of interests in oil fields: anti-avoidance

617. This section is based on section 64 of CAA 1990. It provides a rule that prevents the new owner of plant of machinery attributable to an interest in an oil field bringing in as qualifying expenditure more than the cost to the previous owner.

Section 167: Oil production sharing contracts

618. This section and sections 168 to 171 are based on section 64A of CAA 1990. They deal with oil production sharing contracts. In summary:

- a production sharing contract is a contract between an oil enterprise (normally a company) and a government for production of oil to be shared between the company and the government;

- the contractor develops the field under the contract and incurs expenditure on plant and machinery to generate the production;
- the contract provides that the plant and machinery is transferred to the government;
- the contract may be exclusive or there may be other companies involved ("participators");
- the contracts may be transferred; and
- the ordinary plant and machinery rules do not entitle the companies concerned to allowances because they do not own the plant or machinery. Furthermore the transfer itself is a disposal event.

619. This section explains what is meant by a production sharing contract. *Sections 167* to*171* give entitlement to allowances and prevent the transfer being a disposal event.

Section 168: Expenditure on plant or machinery incurred by contractor

620. This section sets out the basic rule for expenditure incurred on plant or machinery by a contractor under a production sharing contract. It allows the expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the contractor.

621. Without this provision contractors would not be entitled to claim capital allowances because the ownership condition in section 11(4)(b) would not be satisfied after the transfer to the government and the transfer itself would be a disposal event.

622. *Subsection (1)* sets out the conditions that need to be satisfied.

623. *Subsection (2)* treats the contractor as owning the plant or machinery until the events identified in paragraph (a) or (b) take place. Section 171 deals with disposal events in those circumstances.

Section 169: Expenditure on plant or machinery incurred by participator

624. This section extends the basic rule in section 168 to include "participators" in production sharing contracts. It allows participators' expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the participator.

625. Without this provision the expenditure would not qualify because the ownership condition in section 11(4)(b) would not be satisfied, and the transfer to the government would be a disposal event.

626. *Subsection (1)* sets out the conditions that need to be satisfied.

627. *Subsection (2)* applies a parallel rule for ownership and cessation of ownership as is provided for contractors in section 168(2). Similarly section 171 deals with disposal events.

Section 170: Participator's expenditure attributable to plant or machinery

628. This section covers the position of participators who acquire an interest in a production sharing contract from a contractor or participator. If:

- part of the expenditure on acquiring the interest is attributable to plant or machinery; and
- that plant or machinery is treated as owned by a contractor or participator under sections 168 or 169,

then this section will allow plant and machinery to qualify for allowances for the participator acquiring the interest.

629. *Subsection (2)* deals with the deemed ownership and says when that comes to an end in a similar way to sections 168(2) and 169(2). Disposal events are given by section 171.

630. *Subsection (3)* creates a disposal event for the person who previously held that interest in the contract, and provides for a disposal value equal to the participators' expenditure. The participator here is the participator in *subsection (1)(a)*. The attributable expenditure is apportioned – see *subsection (6)*.

631. *Subsection (4)* is needed because the participator in this section does not actually incur expenditure on plant or machinery. Instead an interest in a contract has been acquired. This subsection therefore deems the participator to have incurred expenditure and to own it as result of incurring that expenditure. The participator can then claim allowances. In sections 168 and 169 the contractor or participator has actually incurred expenditure on plant or machinery which they own, although it has to be transferred under the contract.

632. *Subsection (5)* deals with the amount of the expenditure that will qualify under this section.

633. *Subsection (6)* provides for a just and reasonable apportionment of the acquisition expenditure to find the amount of expenditure attributable under*subsection (3)*.

Section 171: Disposal values on cessation of ownership

634. This section gives disposal values on cessation of deemed ownership. It applies when the plant or machinery is transferred to the government at the end of the production sharing contract. The disposal events it relates to are in sections 168(2)(a) and (b), 169(2)(a) and (b) and 170(2)(a) and (b). If the contractor or participator receives capital compensation then the disposal value is the amount of that compensation. Otherwise it is nil.

Chapter 14: Fixtures

Overview

635. This Chapter determines entitlement to allowances in respect of capital expenditure on plant and machinery which is or becomes a fixture.

636. Special rules are needed to deal with fixtures since land law treats them as belonging to the owner of the freehold. In many cases, this will mean that the person incurring expenditure on them for use in a qualifying activity will not be the owner of the fixture. In the absence of these rules, many taxpayers incurring capital expenditure on a fixture would fail to qualify for allowances under the general rule in section 11.

637. This Chapter contains six blocks of sections:

- sections 172 to 175 set out the scope of the Chapter and define "fixture" and other terms used in the Chapter;
- sections 176 to 184 determine who is treated as the owner of a fixture and when. The basic rule is that a person who incurs expenditure on a fixture is treated as the owner so long as they have an interest in the relevant land (section 176). Other taxpayers, who may be treated as the owner, are:
  - — an equipment lessor (see section 177);
  - — a person who buys an interest in the land (see sections 181 and 182); and
  - — a lessee (see sections 183 and 184).

It should be noted that sections 193 to 195 also provide for circumstances in which a taxpayer is treated as owning a fixture;

- sections 185 to 187 restrict the amount of qualifying expenditure for plant and machinery allowances in some circumstances. Broadly, these apply if capital allowances have already been claimed in respect of the fixture;
- sections 188 to 192 give disposal events for fixtures in addition to those in Chapter 5;
- sections 193 to 195 provide additional cases in which a taxpayer is treated as owning a fixture. These are listed separately because they are dependent on another taxpayer being treated as ceasing to own the fixture;
- sections 196 to 201 give the disposal values for fixtures. They take the place of the general rules in Chapter 5; and
- sections 202 to 204 deal with interpretation and administrative matters.

Section 172: Scope of Chapter etc.

638. This section is based on parts of sections 51, 52, 53, 54, 55, 56, 56A, 56B, 56C, 57 and 58 of CAA 1990. It defines the scope of the fixtures Chapter.

639. *Subsection (3)* makes clear that the provisions that treat a person as the owner of the fixture are subject to the provisions that treat a person as ceasing to be the owner of the fixture.

640. *Subsection (4)* ensures that references to a person being treated as the owner (or ceasing to be the owner) are references to ownership for the purposes of Part 2.

641. Section 51(1) ensures that if one person is treated as the owner of a fixture then no other person is entitled to an allowance in respect of the fixture. This provision has not been rewritten. See *Change 26* in Annex 1.

Section 173: Meaning of "fixture" and "relevant land"

642. This section is based on section 51(2A) and part of section 51(2) of CAA 1990. It provides a definition of "fixture" and determines what is the "relevant land" for any fixture.

Section 174: Meaning of "equipment lease" and "lease"

643. This section is based on section 53(4) and parts of sections 51(2) and (3) and 53(1) of CAA 1990. It provides definitions for "equipment lease", "equipment lessor", "equipment lessee" and "lease".

644. *Subsection (1)(a)* defines an "equipment lease" as an agreement entered into in the circumstances given in *subsection (2)*. *Subsection (1)(b)* includes the actual lease entered into "under or as a result of such an agreement". Section 53(4) refers to a lease "entered into pursuant to such an agreement". Although the words used in this Act are simpler, the meaning is the same.

Section 175: Meaning of "interest in land", etc.

645. This section is based on section 51(4) and parts of section 51(2) and (3) of CAA 1990. It provides a definition of "interest in land" for the purposes of the Chapter.

646. *Subsection (2)* is necessary because of Northern Ireland land law. In Northern Ireland, it remains possible for mortgagees to hold an interest in land as security. The interest in land may be conveyed or assigned to them. This subsection ensures that it is the

mortgagor (borrower), and not the mortgagee (lender), that is treated as the owner of the interest.

Section 176: Person with interest in relevant land having fixture for purposes of qualifying activity

647. This section is based on part of section 51(1) and (2) of CAA 1990. It provides one of the ways in which a person may be treated as the owner of a fixture.

648. This provision deals with the circumstances in which a person, with an interest in the relevant land, incurs capital expenditure on the provision of plant or machinery and the plant or machinery becomes a fixture. *Subsection (1)* deals with this basic rule.

649. *Subsections (2)* and *(3)* provide tie-breaker rules if two (or more) persons might otherwise be treated as the owner under subsection (1). In *Rule 3*, it is the lesser interest that qualifies.

Example

Suppose R and J would both be treated as the owner of a fixture under subsection (1). The interest in the relevant land held by R is the fee simple estate. J has a leasehold interest in the land.

Provided that Rules 1 and 2 do not apply in respect of any other person, then J (and not R) may be treated as the owner of the fixture because J's interest is not in reversion on the interest held by R.

Section 177: Equipment lessors

650. This section is based on section 53(1A) and on part of section 53 of CAA 1990. The section deals with the cases which allow equipment lessors to be treated as the owner of a fixture.

651. There are three sets of rules that allow equipment lessors to be treated as the owner of a fixture. The conditions that need to be met are in sections 178 to 180. *Subsection (1)* sets out the conditions that need to be met in all three cases.

652. *Subsections (2)* and *(3)* deal with the time from which the equipment lessor may be treated as the owner of the fixture. This is generally the time when the equipment lessor incurs the capital expenditure on the plant or machinery. However, this is modified if the conditions of section 178 are met (and the conditions of sections 179 and 180 are not met). If the equipment lessee does not yet carry on the qualifying activity, then the equipment lessor is not be treated as the owner of the fixture until the time when the equipment lessee begins to carry on the qualifying activity. See *Note 37* in Annex 2.

Section 178: Equipment lessee has qualifying activity etc.

653. This section is based on part of section 53(1) of CAA 1990. It sets out the additional conditions that need to be met for an equipment lessor to be treated as the owner if the plant or machinery is provided for the purposes of the equipment lessee's qualifying activity.

Section 179: Equipment lessor has right to sever fixture that is not part of building

654. This section is based on section 53(1C) and on part of section 53(1B) of CAA 1990. This provision was introduced in FA 1997 to treat lessors of street furniture (for example bus-shelters) as the owner of the fixture. The section contains the additional conditions that need to be met in such cases.

Section 180: Equipment lease is part of affordable warmth programme

655. This section is based on section 53(1E) and (1F) and on part of section 53(1D) and (1G) of CAA 1990. These provisions were introduced in FA 2000 to treat lessors of domestic heating equipment as the owner of the fixture. The section contains the additional conditions that need to be met in such cases.

Section 181: Purchaser of land giving consideration for fixture

656. This section is based on part of sections 54 and 56A of CAA 1990. The section sets out the conditions that need to be met if the purchaser of an interest in the relevant land is to be treated as the owner of the fixture.

657. This section only deals with cases in which a person purchases an existing interest in the relevant land.

658. The basic rule is dealt with in *subsection (1)*. *Subsections (2)* and *(3)* provide that subsection (1) does not apply if another person is treated as the owner of the fixture in respect of a different interest in the relevant land.

Example

L Limited owns the fee simple estate in a building. The company incurs capital expenditure on the provision of a fixture for the purposes of its qualifying activity. Suppose, however, that the company does not make a claim in respect of its expenditure (as defined in section 202).

Suppose also that H Limited has a leasehold interest in the building and that H Limited assigns this interest to N Limited. Provided that N's consideration for the lease includes a capital sum that falls to be treated as expenditure on the provision of the fixture, then N Limited would be treated as the owner of the fixture under this section.

However, if L Limited were to make a claim then subsections (2) and (3) of this section would prevent N Limited from being treated as the owner of the fixture.

Section 182: Purchaser of land discharging obligations of equipment lessee

659. This section is also based on part of sections 54 and 56A of CAA 1990. The section provides an equivalent to the previous section if the fixture was let under an equipment lease. It deals with cases in which the person acquiring the interest in the relevant land pays a capital sum to discharge the obligations of the equipment lessee under the equipment lease.

660. The basic rule is dealt with in *subsection (1)*. *Subsections (2)* and *(3)* provide that subsection (1) does not apply if another person is treated as the owner of the fixture in respect of a different interest in the relevant land.

661. This section does not deal with cases in which the equipment lessor is treated as the owner of the fixture under section 177. Instead, such situations are dealt with in sections 192 and 195.

Section 183: Incoming lessee where lessor entitled to allowances

662. This section is based on section 55 of CAA 1990. It deals with cases in which a lease is granted in the relevant land and the lessor is entitled to an allowance. It also covers cases in which the lessor is not entitled to an allowance simply because the lessor is not within the charge to tax. The section provides when the new lessee may be treated as the owner of a fixture.

663. Because the section effectively transfers deemed ownership from the lessor to the lessee it is necessary for both to make an election for these provisions to apply.

664. One of the conditions for this section to apply is that the lessor is entitled to an allowance in respect of the fixture for the chargeable period in which the lease is granted. CAA 1990 deals with this in section 55(1)(b). However, it includes the words "apart from section 57"; section 57 deals with fixtures treated as ceasing to belong to a person. These words have no effect and have not been rewritten.

Section 184: Incoming lessee where lessor not entitled to allowances

665. This section is based on part of sections 56 and 56A of CAA 1990. It is similar to section 183 but deals cases in which the lessor is not entitled to an allowance (or would not be entitled even if the lessor were within the charge to tax).

666. As the lessor is not giving up ownership in such situations, there is no requirement for an election. However, a restriction applies if another person is treated as the owner of the fixture in respect of a different interest in the relevant land. This is dealt with in *subsections (2)* and *(3)*.

Section 185: Fixture on which a plant and machinery allowance has been claimed

667. This section is based on section 56B of CAA 1990. It restricts the amount of expenditure that may be taken into account if a previous "owner" has claimed a plant and machinery allowance in respect of the fixture.

668. The broad effect of this section is to restrict the amount of future claims to the lowest disposal value brought into account by previous owners. This provision ensures that taxpayers cannot artificially inflate the amount attributed to a fixture on which plant and machinery allowances may be available at the expense of land on which plant and machinery allowances are not available. The limit is known as the "maximum allowable amount".

669. *Subsection (2)(b)* ensures that if excessive expenditure has already been taken into account, then an adjustment should be made.

670. *Subsection (3)* provides that the "maximum allowable amount" may be increased to the extent that any of the new qualifying expenditure falls within section 25.

671. *Subsection (4)* ensures that if more than one disposal event has occurred, then the section only considers the most recent event. *Subsection (5)* makes it clear that a person's qualifying expenditure may be restricted by reference to a disposal value brought into account by the same person in respect of a previous period of ownership.

672. If there is a sale of the plant or machinery as a chattel between unconnected persons, then *subsections (6)* and *(7)* provide that taxpayers may ignore ownership and disposal values in respect of any time before such a sale.

Section 186: Fixture on which an industrial buildings allowance has been made

673. This section is based on section 56C of CAA 1990. It restricts the amount of expenditure that may be taken into account if a person has claimed an industrial buildings allowance in respect of the fixture.

674. There is a general rule in section 9 that a fixture on which an industrial buildings allowance has been claimed may not be subject to a claim for plant and machinery allowances. However, this rule is relaxed if this section applies.

675. If this section applies, the qualifying expenditure is restricted to a proportion of the residue of the expenditure (as defined in section 313). This proportion is the proportion of the consideration that relates to the fixture on the transfer from the former owner.

Section 187: Fixture on which a research and development allowance has been made

676. This section is based on section 56D of CAA 1990. It restricts the amount of expenditure that may be taken into account if a person has claimed a R&D allowance in respect of the fixture.

677. As in the previous section, the rule in section 9 is relaxed if this section applies.

678. If this section applies, the qualifying expenditure is restricted to a proportion relating to the fixture of the Part 6 expenditure (or, if lower, the disposal value brought into account).

Section 188: Cessation of ownership when person ceases to have qualifying interest

679. This section is based on part of section 57(2) to (4) of CAA 1990. It provides that a taxpayer is treated as ceasing to own a fixture when ceasing to have the “qualifying interest”.

Section 189: Identifying the qualifying interest in special cases

680. This section is based on part of section 57(3) of CAA 1990. It provides that in certain circumstances, a person is not treated as ceasing to own a fixture even when ceasing to own the “qualifying interest”.

681. These circumstances broadly apply when the person acquires another interest in the relevant land which replaces the previous “qualifying interest”. In such cases, the new interest becomes the qualifying interest.

Section 190: Cessation of ownership of lessor where section 183 applies

682. This section is based on section 57(5) of CAA 1990. It applies if an incoming lessee begins to be treated as the owner of a fixture under section 183.

683. One of the conditions for section 183 to apply is that the lessor is treated as the owner of the fixture. This section provides that when the lessee begins to be treated as the owner of the fixture, the lessor must be treated as ceasing to be the owner.

Section 191: Cessation of ownership on severance of fixture

684. This section is based on section 57(7) of CAA 1990. It deals with cases in which a fixture is permanently severed from the relevant land.

685. In such cases, the person who was previously treated as owning the fixture is treated as ceasing to own it. However, this does not apply if the person becomes the actual owner of the plant or machinery as a result of the severance.

Section 192: Cessation of ownership of equipment lessor

686. This section is based on part of section 58(1) and (5) of CAA 1990. It provides for cases in which an equipment lessor is to be treated as ceasing to own the fixture.

687. This section applies if either:

- the equipment lessor assigns the rights under the equipment lease; or
- the equipment lessee’s financial obligations are discharged.

688. *Subsection (3)* provides that references to “equipment lessee” include any person in whom the financial obligations under the equipment lease may have been vested.

Section 193: Acquisition of ownership by lessor or licensor on termination of lease or licence

689. This section is based on section 57(6) of CAA 1990. It deals with cases in which a person is treated as ceasing to be the owner of a fixture because of the termination of the person's interest in the relevant land under section 188.

690. The section applies if the interest is a lease or a licence. In such cases the lessor (or licensor) under the lease (or licence) is treated as the owner of the fixture from that time.

Section 194: Acquisition of ownership by assignee of equipment lessor

691. This section is based on section 58(3) and part of section 58(2) of CAA 1990. It deals with cases in which, under section 192, an equipment lessor assigns the rights under the equipment lease.

692. This section provides that the assignee is treated as being the owner of the fixture. Further, the assignee is treated as incurring on the provision of the fixture any consideration given for the assignment.

693. *Subsection (2)* provides that the assignee is subsequently treated as an equipment lessor for the purposes of sections 192 and 195 and future operations of *subsection (1)* of this section.

Section 195: Acquisition of ownership by equipment lessee

694. This section is based on part of section 58(4) and (5) of CAA 1990. It provides that an equipment lessee may be treated as being the owner of a fixture. This section applies if:

- in a case dealt with by section 192, it is the equipment lessee who discharges the equipment lessee's financial obligations under the equipment lease; and
- the equipment lessee does so by paying a capital sum.

695. *Subsection (2)* provides that references to "equipment lessee" include any person in whom the financial obligations under the equipment lease may have been vested.

Section 196: Disposal values in relation to fixtures: general

696. This section is based on sections 57(1) and 59 and part of section 58(2), (4) and (5) of CAA 1990. It determines the basic disposal value to be taken into account in different scenarios in respect of a fixture.

697. *Subsection (1)* provides a Table showing the different disposal values depending on the circumstances. Item 2 of the Table refers to a condition that needs to be satisfied. The alternate legs of this condition are in *subsection (2)*.

698. *Subsection (3)* makes it clear that disposals dealt with by item 1 or 5 are subject to an election being made under section 198 or 199.

699. *Subsection (4)* provides that references to "equipment lessee" include any person in whom the financial obligations under the equipment lease may have been vested.

700. *Subsection (5)* makes it clear that a taxpayer may need to bring a disposal value into account under the rules of Chapter 5 because of an event not covered by this Chapter.

701. *Subsection (6)* makes it clear that these disposal values are subject to section 197 which deals with avoidance cases.

702. Section 59(11) of CAA 1990 has been rewritten in paragraph 41 of Schedule 3.

Section 197: Disposal values in avoidance cases

703. This section is based on section 59A(1) to (3) of CAA 1990. It substitutes a "notional written-down value" for the disposal value in avoidance cases.

704. *Subsection (1)(d)* refers to a taxpayer obtaining a "tax advantage". This term is defined in section 577(4).

705. The paragraph also refers to a disposal event which "is part of, or occurs as a result of" a scheme or arrangement. Section 59A(1)(c) of CAA 1990 uses the words "is comprised in, or occurs in pursuance of". The wording in this Act is simpler than that in CAA 1990 without changing its meaning.

706. *Subsection (3)* uses a formula to define the "notional written-down value" in line with the similar provisions elsewhere in this Act. See *Note 24* in Annex 2.

Section 198: Election to apportion sale price on sale of qualifying interest

707. This section is based on part of section 59B(1) to (4) of CAA 1990. It provides that, in certain circumstances, the parties to a transaction may elect to fix a disposal and acquisition value in respect of a fixture.

708. *Subsection (1)* ensures that an election under this section may only apply if the disposal event is one for which item 1 of the Table in section 196 would otherwise apply. (This item applies if there is a sale of the qualifying interest, but item 2 of the Table does not apply.)

709. *Subsection (2)* ensures that the amount fixed by the election is to be used as the disposal value instead of the value determined by item 1. It also ensures that the amount is to be used for other purposes of this Part. In particular, if the purchaser is to claim allowances in respect of the fixture then the election will determine the expenditure treated as incurred. In all cases, this subsection provides that the election must be made jointly by the purchaser and seller.

710. *Subsection (3)* provides two limits for the amount that may be fixed under an election under this provision. The amount may not exceed the actual sale price. It must also not exceed the amount which was treated as incurred by the seller on the provision of the fixture.

711. *Subsection (4)* deals with the attribution of any part of the sale price not attributed to the fixture by the election.

712. *Subsection (5)* provides that an election cannot override a restriction on allowances under section 186 or 187. If appropriate, those sections still apply to limit the purchaser's expenditure that may be brought into account under the rules for plant and machinery allowances.

713. The subsection also ensures that the seller's disposal proceeds may still be substituted by the notional written-down value in avoidance cases (see section 197).

Section 199: Election to apportion capital sum given by lessee on grant of lease

714. This section is also based on part of section 59B(1) to (4). It provides that the parties to a transaction may elect to fix a disposal and acquisition value in respect of a fixture in cases dealt with by item 5 of the Table in section 196.

715. *Subsection (2)* ensures that the amount fixed by the election is to be used as the disposal value instead of the value determined by item 5. It also ensures that the amount is to be used for other purposes of this Part. In particular, if the incoming lessee is to claim allowances in respect of the fixture then the election will determine the expenditure treated as incurred. In all cases, this subsection provides that the election must be made jointly by the lessor and the lessee.

716. *Subsection (3)* provides two limits for the amount that may be fixed under an election under this provision. The amount may not exceed the actual capital sum incurred by the lessee. It must also not exceed the amount which was treated as incurred by the lessor on the provision of the fixture.

717. *Subsection (4)* deals with the attribution of any part of the capital sum not attributed to the fixture by the election.

718. *Subsection (5)* provides that an election cannot override a restriction on allowances under section 186 or 187. If appropriate, those sections still apply to limit the lessee's expenditure that may be brought into account under the rules for plant and machinery allowances.

719. The subsection also ensures that the lessor's disposal proceeds may still be substituted by the notional written-down value in avoidance cases (see section 197).

Section 200: Elections under section 198 and 199: supplementary

720. This section is based on section 59B(5) and 59C(6) and part of section 59C(3) of CAA 1990. It provides additional rules that apply to elections under either of the previous two sections.

721. *Subsection (2)* ensures that an election overrides any apportionment made under sections 562 to 563.

722. *Subsection (4)* provides for cases in which, after an election is made, circumstances arise which have the effect of reducing the maximum amount that may be fixed under the election (under either section 198(3) or 199(3)). If the reduced value is less than the amount specified by the election, then the election is treated as having specified the lower amount.

Example

V acquires from O the fee simple interest in a building on 1 March 2002. On 2 April 2003, V sells this interest to R.

V and R make an election under section 198 and apportion £10,000 to a fixture. Subsequently, but within the two-year limit imposed by section 201(1), V and O enter into an election and apportion £5,000 to the same fixture.

The election made by O and V fixes V's expenditure on the provision of the fixture at £5,000 for all purposes of the rules for plant and machinery allowances. In particular, it means that on a subsequent transaction involving the fixture, any election under either section 198 or 199 may not apportion an amount more than £5,000 to the fixture. This therefore includes the transaction between V and R.

Even though an election had already been made in respect of the sale by V to R, section 200(4) provides that this election is treated as fixing £5,000 as the consideration in respect of the fixture.

As a result, V must bring a disposal value of £5,000 into account and R may claim allowances in respect of expenditure of only £5,000 and not £10,000. Section 203(4) provides for adjustments to be made (for example to any assessments) as necessary.

Section 201: Elections under sections 198 and 199: procedure

723. This section is based on part of sections 51(2) and 59C of CAA 1990. It contains the procedural rules that apply to elections under sections 198 and 199.

Section 202: Interpretation

724. This section is based on section 51(2), (5) and (5A) and part of section 147(2D) of CAA 1990. It makes provision as to when a person is entitled to an allowance in respect of expenditure on the provision of a fixture. It also defines when "a person makes a claim under this Chapter".

725. As in section 8, this has been rewritten so as to refer to allocating expenditure to a pool. CAA 1990 refers to taking expenditure "into account" for the purposes of section 24 of CAA 1990.

726. *Subsection (1)* means "entitled to an allowance in respect of expenditure on the provision of a fixture" includes having a pool to which that expenditure has been allocated.

727. This ensures that the term picks up cases in which:

- a balancing charge arises in a particular pool; and
- the amount of the balancing charge is reduced because of the expenditure having been allocated to the pool.

728. *Subsection (2)* restricts this rule. It ensures that the term does not apply to a particular pool if, in a previous chargeable period, the taxpayer has been required to bring a disposal value into account in the pool in respect of the fixture.

729. Only disposal values brought into account by virtue of section 61(1) are affected by this. So, for example, a taxpayer is "entitled to an allowance" even if an additional VAT rebate has been made in respect of the fixture.

730. Furthermore, if a taxpayer starts to use a fixture partly for purposes other than that of the qualifying activity, a disposal value will be brought into account in respect of the pool to which the expenditure on the provision of the fixture was originally allocated. Subsection (2) means that the taxpayer will not be "entitled to an allowance in respect of the fixture" as far as that pool is concerned. However, the re-allocation of expenditure to a single asset pool under section 206(3) will mean that the taxpayer will be "entitled to an allowance in respect of the fixture" as far as the single asset pool is concerned. This is until there is a disposal event in respect of the single asset pool. The same applies if the taxpayer is in receipt of a partial depreciation subsidy.

731. *Subsection (3)* defines what is meant in the Chapter by "making a claim" in respect of expenditure.

Section 203: Amendment of returns and adjustment of assessments

732. This section is based on sections 51(6) and (6A) and 53(1H) and part of sections 51(2) and 53(1G) of CAA 1990. It puts an obligation on taxpayers to notify the Inland Revenue if a return has become incorrect for one of four specified reasons. It also provides that any necessary adjustments may be made to give effect to the various provisions of the Chapter.

733. *Subsection (2)* lists the four reasons that could give rise to an obligation on the taxpayer to notify the Inland Revenue of any return that has become incorrect.

734. *Subsection (3)* requires the notice to be given within three months of the taxpayer first becoming aware that the return had become incorrect because of such a reason. To deal with cases in which the taxpayer does not meet this obligation, there are penalty provisions within section 98 of TMA 1970.

735. *Subsection (4)* provides that any necessary adjustments may be made to give effect to the various provisions of the Chapter.

Section 204: Appeals etc.

736. This section is based on sections 51(7) and 59C(8) of CAA 1990. It provides for special rules in appeals cases involving fixtures.

737. *Subsections (1)* to *(3)* deal with cases in which:

- there is a question as to whether any plant or machinery is a fixture; and
- that question is material to the tax liability of two or more persons.

738. *Subsections (4)* to *(6)* consider cases in which there is a question relating to an election under section 198 or 199 which is to be determined by the Special or General Commissioners.

739. These special rules are required as hearings by Commissioners are usually in private and these situations affect the tax liabilities of different taxpayers. It is therefore necessary to modify the normal procedures to allow all parties to appear before, or make written representations to, the Commissioners.

Chapter 15: Asset provided or used only partly for qualifying activity

Overview

740. This Chapter restricts writing-down allowances, balancing allowances and balancing charges for plant and machinery which is provided or used only partly for the purposes of the qualifying activity.

741. Section 205 deals with the reduction of first-year allowances if it appears that the plant or machinery is provided only partly for the qualifying activity.

742. Section 206 provides that qualifying expenditure on plant or machinery provided or used partly for the purposes of the qualifying activity and partly not is allocated to a single asset pool. It also gives rules for that pool.

743. Section 207 reduces writing-down allowances, balancing allowances and balancing charges for plant or machinery used partly for the purposes of the qualifying activity and partly not.

744. Section 208 is an anti-avoidance provision. It provides a disposal event if:

- there is a significant reduction in the use for the purposes of the qualifying activity; and
- the market value of the asset exceeds the available qualifying expenditure in the single asset pool by more than £1 million.

Background

745. The general conditions as to availability of plant and machinery allowances are in section 11. Subsection (4)(a) says that expenditure on the provision of plant or machinery has to be wholly or partly for the purposes of the qualifying activity. This Chapter explains how allowances are computed if use is only “partly”.

746. The idea is that allowances should be restricted in a “ just and reasonable” way having particular regard to the extent to which the plant or machinery is used for purposes other than those of the qualifying activity. In practice this means that allowances are reduced proportionately for non-qualifying use (for example, private use in the case of a sole trader).

747. It would be impossible to achieve the correct adjustment if the expenditure was pooled with expenditure on other plant or machinery. So this Chapter requires a single asset

pool. For rules about pooling in general see Chapter 5. Section 54(2) contains the rule that a single asset pool cannot contain expenditure relating to more than one asset.

Section 205: Reduction of first-year allowances

748. This section is based on section 79(1) of CAA 1990. It restricts first-year allowances.

749. *Subsection (1)* restricts a first-year allowance if it appears that the plant or machinery will be used for purposes other than those of the qualifying activity. The reduction of allowances must be just and reasonable having regard to the relevant circumstances.

750. *Subsection (2)* expands the meaning of “relevant circumstances”. These include looking forward to the extent to which the plant or machinery is likely to be used for purposes other than those of the qualifying activity. There may be other circumstances.

751. *Subsection (3)* is makes clear the reduction in first-year allowances does not increase the qualifying expenditure on which writing-down allowances can be claimed in later chargeable periods. See *Note 38* in Annex 2.

Section 206: Single asset pool etc.

752. This section is based on section 79(2), (3) and (4) of CAA 1990. It provides for single asset pools for all expenditure incurred partly for the purposes of the qualifying activity and partly for other purposes.

753. *Subsections (1)* and *(2)* set up the single asset pool.

754. *Subsection (3)* sets up a single asset pool when any expenditure already in a pool starts to be use partly for purposes other than those of the qualifying activity. The plant or machinery will previously have been used wholly for the purposes of the qualifying activity. This subsection picks up the consequences of the disposal event in section 61(1)(e). The value of the disposal event will be market value, derived from the Table in section 61.

755. *Subsection (4)* disapplies section 61(1)(e) for expenditure already in a single asset pool under this Chapter.

Section 207: Reduction of allowances and charges on expenditure in single asset pool

756. This section is based on section 79(2), (5) and (6) of CAA 1990. It provides rules for balancing allowances and charges which are equivalent to those for writing-down allowances.

757. *Subsection (3)* expands the meaning of “relevant circumstances”. These include looking forward to the extent to which the plant or machinery is likely to be used for purposes other than those of the qualifying activity. There may be other circumstances, including for example use in previous years.

758. *Subsection (4)* is new and is intended to clarify the position in future years of qualifying expenditure which was subject to a restriction of writing-down allowances under this section. See *Note 38* in Annex 2.

Section 208: Effect of significant reduction in use for purposes of qualifying activity

759. This section is based on section 79A of CAA 1990 which was introduced by section 79(2) of FA 2000. It is an anti-avoidance rule. It provides for a special disposal event at market value if:

- there is a significant reduction in the use for the purposes of the qualifying activity; and

- the market value of the asset exceeds the available qualifying expenditure in the single asset pool by more than £1 million.

760. *Subsection (1)* sets out the conditions that have to apply and *subsection (2)* gives the effect. The disposal value in *subsection (2)* will be market value (from the Table in section 61).

761. *Subsection (2)* will mean that the single asset pool ends and a new one begins because of the general pooling rules for the final chargeable period in section 65.

Chapter 16: Partial depreciation subsidies

Overview

762. This Chapter deals with partial depreciation subsidies. These occur if some other person makes a payment to take account of some of the depreciation on an asset.

763. Section 209 defines "partial depreciation subsidy".

764. Section 210 reduces first-year allowances if it appears that there will be a partial depreciation subsidy.

765. Section 211 provides that qualifying expenditure subject to a partial depreciation subsidy is allocated to a single asset pool and gives rules for that pool.

766. Section 212 provides for the reduction of writing-down allowances, balancing allowances and balancing charges for expenditure in a single asset pool under this Chapter.

Background

767. If the payment covers all of the depreciation, section 37 will prevent the plant or machinery qualifying for allowances unless the payment is taken into account as income.

768. This Chapter is similar to Chapter 15 in that it provides for a just and reasonable reduction of allowances and charges and for single asset pools to enable the reductions to be taken into account.

769. It would be impossible to achieve the correct adjustment if expenditure on the asset were kept in a pool with other assets. So this Chapter provides for single asset pools. For rules about pooling in general see Chapter 5. Section 54(2) contains the rule that a single asset pool cannot contain expenditure relating to more than one asset.

770. Section 80(7) of CAA 1990 has not been rewritten as such because it defines a term, "relevant period", which is not necessary in this Act.

Section 209: Meaning of "partial depreciation subsidy"

771. This section is based on section 80(1), (2) and (3) of CAA 1990. The term "depreciation subsidy" is new and is used in this Act instead of the term "wear and tear subsidy" which is used by section 80 of CAA 1990. See *Note 13* in Annex 2.

Section 210: Reduction of first-year allowances

772. This section is based on section 80(2) of CAA 1990. It provides for a just and reasonable reduction to any first-year allowance if it is appears that there will be a partial depreciation subsidy payable during the period of use.

773. *Subsection (2)* is new and is intended to clarify the position in future years of qualifying expenditure if a first-year allowance has been claimed which was subject to a restriction under this Chapter. See *Note 38* in Annex 2.

Section 211: Single asset pool etc.

774. This section is based on section 80(3), (4), (5) and (7) of CAA 1990. It sets up a single asset pool for qualifying expenditure on plant or machinery when a partial depreciation subsidy is paid.

775. *Subsections (3)* and *(4)* apply if the expenditure has already been allocated to a pool, and not previously been subject to a partial depreciation subsidy. When the subsidy is paid, there is a special disposal event and a single asset pool is set up. This is a disposal event in addition to those listed in section 61(1). The disposal value will be market value, as derived from the Table in section 61.

776. *Subsection (5)* stops there being a disposal event if:

- there is a change in the subsidy; and
- the expenditure is already in a single asset pool under this Chapter.

Section 212: Reduction of allowances and charges on expenditure in single asset pool

777. This section is based on section 80(3), (5)(b) and (6) of CAA 1990. It deals with the reduction of writing-down allowances, balancing allowances and balancing charges if a partial depreciation subsidy is paid.

778. *Subsection (3)* is new and is intended to clarify the position in future years of qualifying expenditure if a first-year allowance has been claimed which was subject to a restriction under this Chapter. See *Note 38* in Annex 2.

Chapter 17: Anti-avoidance

Overview

779. This Chapter restricts capital allowances on certain transactions in plant and machinery. It applies if:

- a person acquires plant or machinery by purchase, a hire-purchase type contract or assignment of such a contract; and
- the transaction is between connected persons, or to obtain a tax advantage or a sale and leaseback.

780. The Chapter has four main blocks of legislation:

- section 213 gives an overarching definition of the type of transaction that is targeted;
- sections 214 to 218 prevent or restrict allowances in transactions that do not involve a finance lease;
- sections 219 to 226 prevent or restrict allowances if a finance lease is involved; and
- sections 227 to 232 deal with other miscellaneous matters.

History

781. Section 78 of, and Schedule 7 to, CAA 1968 contained anti-avoidance rules in respect of plant and machinery transactions. These related to, among other things, sales between connected persons and "sole or main benefit" transactions.

782. FA 1971 included, in paragraph 3 of Schedule 8, new anti-avoidance rules intended to prevent the artificial acceleration of allowances. They form the basis of section 75 of CAA 1990.

783. Section 68(3) to (7) and (10) of FA 1972 introduced further anti-avoidance rules. These form the basis of section 76 of CAA 1990. They deal mainly with:

- sale and leaseback transactions if the leaseback was not to the seller but to a person connected with the seller; and
- cases in which there was no continuity of use for the purposes of the seller's business before and after the sale and leaseback.

784. The 1972 provisions worked by extending the 1971 rules. This approach was preserved in sections 75 and 76 of CAA 1990.

785. Section 59 of, and paragraph 11 of Schedule 14 to, FA 1991 made further changes. These ensured that the rules worked properly when the expenditure concerned carried an additional VAT liability.

786. Further provisions to prevent tax loss arising from certain finance leasing arrangements were enacted in paragraph 11 of Schedule 12 to FA 1997 and in sections 44 to 47 of F(No.2)A 1997. Those relevant to this Chapter are:

- a definition of "finance lease" (section 82A of CAA 1990);
- a rule to restrict writing-down allowances on expenditure on plant and machinery for finance leasing in the chargeable period in which it is incurred (section 25(5A) to (5C) of CAA 1990);
- extensions to the rules in sections 75 and 76 to apply in cases of sale and leaseback if the leaseback is under a finance lease (section 76A of CAA 1990); and
- a rule modifying the provision on hire-purchase type arrangements in section 60 if plant or machinery is acquired for finance leasing (section 60(2A) of CAA 1990).

787. Finally, further rules were added by section 77(1) of FA 2000. That inserted section 76B of CAA 1990. It applies, on election, only in cases of sale and leaseback. It relaxes some of the restrictions on the lessor's entitlement to writing-down allowances. It applies whether or not a finance lease is involved.

Structure of Chapter 17

788. This Chapter restructures the anti-avoidance provisions in CAA 1990 to:

- integrate common aspects of that legislation: sections 75, 76 and 76A of CAA 1990 apply as "layers" created by successive Finance Acts which progressively modified the legislation. As a result that legislation operates as a series of extensions: section 76 extends the section 75 rules; and section 76A extends the section 75 rules as extended by section 76. That does not make for easy reading;
- group related provisions together: for example, section 76A of CAA 1990 applies only if a finance lease is involved. That type of case is likely to be of interest to even fewer users than Chapter 17 as a whole. So the sections applying only to finance lease cases (sections 219 to 226) come after the sections which apply in other cases;
- deal in separate sections with distinct rules: for example, the three cases in which a "relevant transaction" may occur are each the subject of a separate section (sections 214 to 216).

Section 213: Relevant transactions: sale, hire-purchase (etc.) and assignment

789. This section is based mainly on section 81(3) and parts of section 75(1), (2) and (3) of CAA 1990. It introduces and defines the term "relevant transaction" which is central in determining when this Chapter applies.

790. *Subsection (1)* identifies the three methods of acquisition which are "relevant transactions". It also introduces the convention of using "B" and "S" to represent what may be thought of as the "buyer" and the "seller" in these transactions. (They may not be literally a buyer and a seller – for example if the transaction is the assignment of rights under a contract.) The commentary on this Chapter uses "buyer" and "seller" similarly.

791. *Subsection (2)* defines the expenditure subject to the rules: capital expenditure incurred under relevant transactions.

792. *Subsection (3)* is based on section 81(3). It allows the anti-avoidance provisions in this Chapter to work properly if a person brings plant or machinery received as a gift into use for business purposes. That person is treated as having incurred capital expenditure in buying the plant or machinery from the donor.

Sections 214 to 216: Connected persons, transactions to obtain allowances, and sale and leaseback etc.

793. These three sections are based on parts of section 75(1), (2) and (3) and 76(1) of CAA 1990. They give the three types of relevant transaction which lead to restrictions on allowances:

- between connected persons;
- to obtain allowances; and
- sale and leaseback (and so on).

794. "Connected persons" for this purpose are defined in section 232.

795. *Section 216* identifies sale and leaseback type transactions in subsection (1)(b):

- paragraph (i) is the basic case dealt with in section 75 of CAA 1990 (which applies if an asset has been used in the seller's business and continues to be so used after the sale); and
- paragraph (ii) covers the circumstances dealt with in section 76(1) of CAA 1990 (which applies if the asset is used by a connected person or there is not necessarily continuity of use in S's business).

Section 217: No first-year allowance for B's expenditure

Section 218: Restriction on B's qualifying expenditure

796. These sections are based on sections 75(1), (2) and (3) and 76(2), (4) and (7) of CAA 1990. They restrict the buyer's allowances if a relevant transaction is within sections 214 to 216:

- *section 217* denies the buyer first-year allowances; and
- *section 218* restricts the buyer's qualifying expenditure. This stops a buyer getting more capital allowances by, for example, paying a connected person over the odds for plant or machinery.

797. But if the transaction is a sale and finance leaseback sections 223 to 225 apply instead.

Section 219: Meaning of "finance lease"

798. This is the first of a group of nine sections which deal with transactions involving finance leases. It is based on part of section 82A of CAA 1990. It defines "finance lease" for the purposes of this Chapter.

799. The definition relies on the treatment of the lease in the accounts which is required under normal accountancy practice. *Subsection (2)* makes clear that this test is applied

as if the lessor and connected persons were United Kingdom companies. See *Note 39* in Annex 2.

800. *Subsection (3)* defines "accounts" for this section. It means that the accountancy treatment test must be applied also to the consolidated accounts of any group to which the lessor belongs or would, under United Kingdom company law, belong if it were a United Kingdom company.

Section 220: Allocation of expenditure to a chargeable period

801. This section is based on section 25(5A) to (5C) of CAA 1990. Its effect is to restrict qualifying expenditure (and so writing-down allowances) for the first chargeable period if finance lessors incur expenditure part-way through the chargeable period.

802. *Subsection (1)* derives from section 25(5A). That provision provides for expenditure incurred in a chargeable period not to be taken into account, except for any part relating to the time after it is incurred. This Act expresses this rule more simply by turning it around to prevent expenditure relating to the time before it is incurred being taken into account.

803. *Subsection (1)(b)* is based on section 25(5C). Section 25(5C) is necessary in CAA 1990 because section 25(1)(a)(i) excludes from a person's qualifying expenditure any expenditure "any part of which" has formed part of that person's qualifying expenditure for a previous chargeable period. Because of the way in which this Act rewrites section 25(1)(a) no equivalent of section 25(5C) is strictly needed. But the reader of this section may not be sure whether subsection (1)(a) merely delays the expenditure from forming part of the available qualifying expenditure or excludes it permanently. Subsection (1)(b) makes the position clear.

804. *Subsection (2)* is based on section 25(5B). It disapplies the rule in subsection (1)(a) if a disposal value has to be brought into account in the same chargeable period in which the expenditure is incurred. It leaves the person to get relief as usual for the qualifying expenditure less the disposal value.

Section 221: Meaning of "sale and finance leaseback"

805. This and the following five sections only apply if a sale and leaseback involving a finance lease is involved.

806. In CAA 1990 such cases are dealt with (in section 76A) as an extension to the basic section 75 or 76 case. And the different aspects are all included in the same section. This Act brings together in one group all the rules for this kind of case but in a separate section for each aspect.

807. This section is based mainly on parts of sections 75, 76 and 76A of CAA 1990. It introduces and defines the term "sale and finance leaseback".

Section 222: Disposal value restricted

808. This section is based on mainly on sections 76A(5), (6) and (10) of CAA 1990. It restricts the seller's disposal value if a sale and finance leaseback is involved.

809. *Subsection (2)* lists directly the different values to be compared to arrive at the disposal value. This is based on some particularly complex parts of CAA 1990 which require cross-references and comparisons between sections.

810. *Subsection (3)* gives the rules for determining the "notional written-down value" – one of the values listed in subsection (2). In CAA 1990 this is defined by means of a notional trade. Removing that abstraction does not change the results from the calculation. See *Note 24* in Annex 2.

811. *Subsection (4)* disapplies this section in sale and finance leasebacks if more than half the risk to the lessor has been removed. In those cases the restrictions are greater: see section 225.

Section 223: No first-year allowance for B's expenditure

812. This section is based on parts of sections 75(1), (2) and (3), 76(1) and 76A(1) of CAA 1990. It prevents any first-year allowance for the buyer's expenditure in sale and finance leaseback cases.

813. In CAA 1990 this is achieved by applying (in section 76A(1)) the "basic" provision in section 75 to such cases. This Act sets out provisions for this special case separately. This section corresponds to section 217.

814. *Subsection (1)* prevents any first-year allowance being made to the buyer under a sale and finance leaseback.

815. *Subsection (2)* provides for the withdrawal of any first-year allowance incorrectly made.

Section 224: Restriction on B's qualifying expenditure

816. This section is based mainly on section 76A(5), (9) and (10) of CAA 1990. It corresponds to section 218. It restricts, for sale and finance leaseback cases, the buyer's available qualifying expenditure (and so restricts entitlement to writing-down allowances).

817. *Subsection (5)* disapplies this section in sale and finance leasebacks if more than half the risk to the lessor has been removed: in those cases the restrictions are greater. See section 225.

Section 225: B's qualifying expenditure if lessor not bearing non-compliance risk

818. This section is based on parts of section 76A(6), (7), (8) and (12) of CAA 1990. It prevents any allowances in sale and finance leaseback arrangements if more than half the risk to the lessor has been removed otherwise than by guarantees by persons connected with the lessor.

819. *Subsection (1)* defines the circumstances in which this section applies.

820. *Subsection (2)* states the effect of the section: the expenditure of the buyer (or of the lessor if they are not the same person) is not qualifying expenditure for capital allowances purposes.

Section 226: Qualifying expenditure limited in subsequent transactions

821. This section is based on section 76A(3), (4) and (7) of CAA 1990. It limits qualifying expenditure for plant or machinery which has been the subject of a sale and finance leaseback which restricted the seller's disposal value. The limit is the sum of:

- the disposal value which was brought into account under section 222; and
- any installation costs allowable under section 25.

Sections 227 and 228: Sale and leaseback or sale and finance leaseback: election for special treatment

822. These two sections are based mainly on section 76B of CAA 1990. They apply, if the parties elect, to transactions involving new and unused assets. They enable writing-down allowances claimed by the buyer (the lessor) to be limited only to the smaller of:

- the cost to the seller (the lessee) or anyone connected with the seller; and
- the sale price to the buyer (the lessor).

823. This applies to both finance lease and non-finance lease cases.

824. In section 227:

- *subsection (2)(b)* is based in part on section 83(1) of CAA 1990 which defines "new";
- *subsection (3)* ensures that the conditions in subsection (1) work properly if the transaction is the assignment of the benefit of a hire-purchase or like contract; and
- *subsection (6)* is an interpretation rule to fix the date of the transaction for the purposes of the election required under subsection (4).

825. Section 228 gives the effect of an election:

- *subsection (1)* disapplies the limits of sections 218 and 224 and substitutes a restriction on the buyer's qualifying expenditure in accordance with *subsections (2)* and *(3)*. The net effect of them is as summarised in paragraph 822 above.
- *subsection (4)* makes this subject to section 225 which prevents any allowance at all in sale and leasebacks if more than half the risk to the lessor has been removed.
- *subsection (5)* states the consequences of the special treatment for the seller: no allowances are due in respect of the seller's expenditure on the asset.

Section 229: Hire-purchases etc.

826. This section is based on sections 25(6) and 60(2A) of CAA 1990. It provides special rules for hire-purchase and similar contracts for this Chapter.

827. Paragraph 351 above mentioned provisions to make sure the disposal value introduced in section 68 does not disadvantage a person to whom the contract is assigned in a transaction within this Chapter. These are those special provisions. They provide, in summary, that the disposal value for the purposes of this Chapter only is what it would have been if:

- there had been an ordinary hire-purchase or similar contract; and
- the plant or machinery had been brought into use.

See *Change 27* in Annex 1.

Section 230: Exception for manufacturers and suppliers

828. This section is based on section 76(5) of CAA 1990. It disapplies the restrictions in sections 217, 218 and 222 to 225 if plant or machinery is sold by the manufacturer, unused and in the ordinary course of the manufacturer's business. The effect is that allowances are given on the sale price of the asset.

Section 231: Adjustment of assessments etc.

829. This section is based on section 75(5) of CAA 1990. It ensures that effect can be given to the provisions of this Chapter.

Section 232: Meaning of "connected person"

830. This section is based mainly on sections 75(4), 76(6)(b) and 76A(11) and parts of sections 76A(12) and 82A of CAA 1990. It defines "connected person" for the purposes of this Chapter.

Section 233: Additional VAT liabilities and rebates

831. Section 233 reflects the way this Act deals separately with additional VAT under the capital goods scheme in Chapter 18. It points to the sections there that relate to Chapter 17.

Chapter 18: Additional VAT liabilities and rebates

Overview

Section 234: Introduction

832. This section introduces terms used in the Chapter. It refers users to the definitions of these terms in Chapter 2 of Part 12.

Section 235: Additional VAT liability treated as qualifying expenditure

833. This section is based on section 24(1A) of CAA 1990. It provides that an additional VAT liability may be treated as further qualifying expenditure.*Subsection (1)* provides the conditions for the section to apply. These are that:

- a person has incurred qualifying expenditure (this is known as “the original expenditure);
- an additional VAT liability is incurred in respect of the original expenditure; and
- the plant or machinery is (still) provided for the purposes of the qualifying activity when the additional VAT liability is incurred.

834. *Subsection (2)(a)* ensures that the additional VAT liability is then treated as further qualifying expenditure in respect of the plant or machinery. This is necessary to ensure that the cap on disposal values in section 62 correctly takes into account the additional VAT liability incurred.

835. *Subsection (2)(b)* allows this further qualifying expenditure to be taken into account in the chargeable period in which the additional VAT liability accrues.

Section 236: Additional VAT liability generates first-year allowance

836. This section is based on section 22(1A) and (1B) of CAA 1990. It ensures that, if the original expenditure also attracted first-year allowances, then the additional VAT liability may also qualify for first-year allowances.

837. *Subsection (2)(a)* provides that the additional VAT liability is the “same type” of first-year qualifying expenditure as the original expenditure. This wording is in line with the heading in the Table in section 52 which provides for different rates of first-year allowance depending on the circumstances of the first-year qualifying expenditure.

838. *Subsection (3)* ensures that:

- the Table of rates of first-year allowances in section 52 applies for the additional VAT liability as well as in respect of the original expenditure; and
- the taxpayer can choose to take a first-year allowance in respect of only part of the further qualifying expenditure.

839. *Subsection (4)* makes it clear that the availability of first-year allowances is subject to the rules in sections 237 (general exceptions) and 241 (anti-avoidance).

840. Some of the first-year allowance rules that could be invoked by this section are not generally relevant to this Act – for example, the rules applying to expenditure incurred between 1 November 1992 and 31 October 1993. If an additional VAT liability is incurred in respect of expenditure that qualified for a first-year allowance under

those rules, the rate of first-year allowance on the additional VAT liability will be in accordance with those rules. For this transitional purpose, these rules are rewritten in paragraphs 46 to 51 of Schedule 3.

Section 237: Exceptions to section 237

841. This section is based on sections 22(3CA) and (6B) and 22B(1) of CAA 1990. It lists some of the circumstances in which a first-year allowance is not available in respect of an additional VAT liability.

842. Other circumstances are provided for in section 241. These circumstances are kept separate because section 241 is part of the anti-avoidance legislation.

843. This Act clarifies the rules that restrict the availability of first-year allowances in respect of additional VAT liabilities. See *Change 28* in Annex 1.

Section 238: Additional VAT rebate generates disposal value

844. This section is based on section 24(7) of CAA 1990. It requires, in certain circumstances, the recipient of an additional VAT rebate to bring the rebate into account as a disposal value. In most cases, this would simply reduce the available qualifying expenditure in the pool to which the original expenditure was allocated.

845. *Subsection (1)(c)* ensures that this section applies only if the recipient of the additional VAT rebate owned the plant or machinery during the chargeable period in which the rebate was made.

846. *Subsections (2)* and *(3)* ensure that the disposal value is brought into account in the chargeable period in which the additional VAT rebate accrues.

847. If another disposal value is to be brought into account in respect of the same plant or machinery in that chargeable period then the amount of the additional VAT rebate is added to this disposal value. The cap on disposal values in section 62 takes into account the combined amounts.

848. If there is no other disposal value to be brought into account in respect of the same plant or machinery in that chargeable period, then the disposal value to be brought into account is the amount of the additional VAT rebate. In these circumstances, the cap on the disposal value is given by section 239.

Section 239: Limit on disposal value where additional VAT rebate

849. This section is based on section 26(2A) and part of section 26(2), (3) and (4) of CAA 1990. It modifies the operation of the cap on disposal value in section 62 if there is, or has been, an additional VAT rebate in respect of the plant or machinery.

850. *Subsections (1)* and *(2)* apply if:

- there is an event giving rise to the disposal value which is not the making of an additional VAT rebate; and
- in respect of the plant or machinery there is an additional VAT rebate either in that chargeable period or in a previous chargeable period.

851. Subsection (2) ensures that the cap on the disposal value is reduced to take into account any previous additional VAT rebates. This ensures that any balancing charge may not exceed the total allowances previously given in respect of the plant or machinery.

852. *Subsections (3)* and *(4)* apply if the only event giving rise to a disposal value is the making of an additional VAT rebate.

853. Subsection (4) provides that the cap on the disposal value is reduced to take into account any previous disposal values brought into account in respect of the plant or machinery as a result of any earlier event.

854. These subsections contain a change. Section 26(2A) of CAA 1990 deals with the cap on disposal value when the event giving rise to the disposal value is the making of an additional VAT rebate. The words at the end of that subsection specifically state that previous additional VAT rebates should not be taken into account when operating the cap. The consequence of this is that in some situations a taxpayer can be required to bring in a disposal value in excess of the total qualifying expenditure incurred on the plant or machinery. This anomaly has been removed. See *Change 29* in Annex 1.

855. *Subsections (5)* and *(6)* modify the special rule in section 62(3). They apply when the person bringing into account a disposal value had acquired the plant or machinery from a connected person. For each connected person in a chain of transactions, it is necessary to calculate the total qualifying expenditure incurred on the plant or machinery net of any additional VAT rebates made. The cap on the disposal value is then the highest net qualifying expenditure of all the persons in the chain.

Section 240: Additional VAT liability

856. This section is based on section 37(4A) of CAA 1990. It applies if an additional VAT liability is incurred in respect of plant or machinery on which a short-life asset election has been made under section 85.

857. If a balancing allowance has been made following a disposal event in respect of a short-life asset pool, this section provides that a subsequent additional VAT liability may give rise to a further balancing allowance.

858. Normally, it is not possible for an additional VAT liability to be qualifying expenditure if it is incurred after the disposal of the plant or machinery. However, this section provides an exception if:

- the plant or machinery was subject to an election under section 85;
- a balancing allowance has arisen in the short-life asset pool;
- an additional VAT liability is incurred after the end of the chargeable period in which the balancing allowance was incurred; and
- the additional VAT liability was not taken into account when calculating the balancing allowance.

Example

S is a partially-exempt trader for VAT purposes. On 24 March 2002, S acquires a computer which is subject to the capital items legislation. For capital allowances, S elects for the expenditure on the computer to be allocated to a short-life asset pool.

Suppose S prepares accounts to 30 June each year, but S's VAT year ends on 31 March. Suppose S prepares quarterly VAT returns. On 1 May 2006, the computer is destroyed by fire. S is not insured for this loss. Suppose also that initial use of the computer was 90% for taxable supplies but this fell to 50% from 1 January 2006.

Under the provisions of section 61, S brings in a nil disposal value into account in the short-life asset pool. This will give rise to a balancing allowance in the chargeable period ending 30 June 2006. Under the capital items legislation, S must account for an additional VAT liability to reflect the reduction in use for taxable supplies in the period before the computer's destruction.

This must be accounted for in respect of the VAT year ending 31 March 2007 and will be shown on the VAT return in respect of the quarter ending 30 September 2007.

For the purposes of this section:

S was entitled to a balancing allowance for the final chargeable period for the short-life asset pool (which ends on 30 June 2006),

S incurred after the end of that period an additional VAT liability (on 31 March 2007); and

S did not bring the additional VAT liability into account in determining the amount of the balancing allowance.

As a result, this section entitles S to a further balancing allowance in respect of the additional VAT liability. Provided that the VAT return is made on time (and that S's trade has not been discontinued before this time) the further balancing allowance will be made in the chargeable period ending 30 June 2007.

Section 241: No first-year allowance in respect of additional VAT liability

859. This is the first of six sections that deal with the VAT aspects of the anti-avoidance provisions in Chapter 17.

860. Section 241 is based on parts of sections 75(1), (2) and (3), 76(1) and 76A(1) of CAA 1990. It ensures that the prohibition on first-year allowances imposed by sections 217 and 223 extends to any additional VAT liability incurred by the buyer in respect of the expenditure under the relevant transaction.

Section 242: Restriction on B's qualifying expenditure: general

861. This section is based on section 76(2), (2A) and (2B) and parts of sections 75(1), (2) and (3) and 76(4) of CAA 1990. It extends and replaces the rules in section 218 to deal with cases that would fall within that section if the expenditure also involves a VAT element. It ensures that the VAT is taken into account when restricting the allowances.

862. *Subsection (1)* applies the provisions of this section in place of those in section 218 when VAT is involved.

863. *Subsection (2)* sets the limit to the available qualifying expenditure by reference to the amounts D and E.

864. *Subsection (3)* defines "E" to include the additional VAT. This is subject to the rule for the case defined in subsection (6).

865. *Subsection (4)* defines "D" if the seller is required to bring a disposal value into account: D is that disposal value.

866. *Subsection (5)* defines "D" if the seller is not required to bring a disposal value into account. That may be because the seller is not within the UK tax net. In these circumstances D is the smallest of the three amounts specified. For those amounts other than the market value, the amount is adjusted to take account of the related VAT element.

867. *Subsection (6)* defines "E" if D is determined under subsection (5), as market value inclusive of VAT. E includes that VAT.

Section 243: Restriction on B's qualifying expenditure: sale and finance leaseback

868. This section is based on parts of sections 75, 76 and 76A of CAA 1990. It extends the rules in section 224 to deal with cases that would fall within that section if the

expenditure also involves a VAT element. It ensures that the VAT expenditure is taken into account in restricting the allowances.

869. *Subsection (1)* applies the provisions of this section in place of those in section 224 when VAT is involved.

870. *Subsection (2)* sets the limit to the available qualifying expenditure by reference to the amounts D and E.

871. *Subsection (3)* defines "E" to include the additional VAT. This is subject to the rule for the case in subsection (7).

872. *Subsection (4)* defines "D" if the seller is required to bring a disposal value into account. In that case D is the amount given by applying the rules in section 222.

873. *Subsection (5)* defines "D" if the seller is not required to bring a disposal value into account. That may be because the seller is not within the UK tax net. In these circumstances D is the smallest of the three amounts specified.

874. *Subsection (6)* imports the meaning of "notional written-down value" (mentioned in subsection (5)) given by section 222(3).

875. *Subsection (7)* defines "E" if D is determined under subsection (5) as market value which is inclusive of VAT: E includes that VAT.

Section 244: B's qualifying expenditure if lessor not bearing non-compliance risk

876. This section is based on parts of section 76A(6), (7) and (8) of CAA 1990. It applies when section 225 applies to the arrangements because more than half the risk to the lessor is removed. It ensures that any additional VAT liability in respect of the expenditure subject to the section 225 restriction cannot, itself, be qualifying expenditure for capital allowances purposes.

Section 245: Effect of election under section 227 on additional VAT liability

877. This section is based on parts of section 76B(3)(a) and (b) of CAA 1990. It ensures that if the special treatment under section 227 applies, the VAT incurred by the lessee is subject to the same restriction as the capital expenditure to which it is related.

878. *Subsection (2)* states the effect of the section if it applies: the VAT element does not entitle the lessee to any capital allowances. This follows the similar prohibition in respect of the capital expenditure itself in section 228(5).

Section 246: Miscellaneous

879. *Subsection (1)* is based on section 75(5) of CAA 1990. It ensures that effect can be given to the sections in this Chapter, relating to the anti-avoidance provisions.

880. *Subsection (2)* is based on section 76A(11) of CAA 1990. It applies the "connected persons" definition in section 232 to the provisions that restrict qualifying expenditure in sections 242 and 243.

Chapter 19: Giving effect to allowances and charges

Overview

881. This Chapter provides how plant and machinery allowances and charges are given effect for income tax and corporation tax. There are specific rules for separate qualifying activities. There are additional rules for life assurance businesses.

882. The general rule in section 2 is applied in detail by:

- section 247 for trades;

- section 248 for ordinary Schedule A businesses;
- section 249 for furnished holiday lettings businesses;
- section 250 for overseas property businesses;
- section 251 for professions and vocations; and
- section 252 for mines, transport undertakings and other "section 55 concerns" (which give effect to allowances as expenses and charges as receipts of the trade or business or concern).

883. In addition:

- section 253 provides for investment companies to give effect so far as possible to allowances as a deduction from income of the business and charges as income of the business;
- sections 254 to 257 give effect to plant and machinery allowances and charges for management assets of a company carrying on life assurance business;
- sections 258 to 261 give effect to allowances and charges for special leasing of plant or machinery as a deduction from income from special leasing or a charge under Case VI of Schedule D respectively; and
- sections 262 gives effect to allowances and charges for employees and office-holders as deductions from emoluments or emoluments respectively.

Sections 247 to 252: ***Trades, property businesses etc.***

884. These sections make very similar provision for giving effect to plant and machinery allowances for trades, property businesses, professions, vocations and section 55 concerns. These are all activities which Part II of CAA 1990 treats as trades for plant and machinery allowances – apart from section 55 concerns – which this Act treats as a qualifying activity. See *Change 1* in Annex 1. The sections are based mainly on section 73(1) of CAA 1990 which provides that allowances and charges are to be given effect in taxing a trade and the bits of Part VIII of CAA 1990 which explain what that means.

Section 253: ***Investment companies***

885. This section is based on section 28 of CAA 1990. It provides for plant and machinery allowances and charges for the management of an investment company to be treated as expenses or income of the business. These are subject then to the provisions in section 75 of ICTA.

886. *Subsections (2)* and *(6)* refer to section 75(4) of ICTA. That provides (after the amendment made by paragraph 15 of Schedule 2 to the Act):

"(4) For the purposes of this section there shall be added to a company's expenses of management in any accounting period the amount of any allowances falling to be made to the company for that period by virtue of section 15(1)(g) of the Capital Allowances Act (plant and machinery allowances) so far as effect cannot be given to them under section 253(2) of that Act.

887. *Subsection (7)* points readers to provisions in ICTA which deal with a change in ownership of an investment company by providing for an apportionment of allowances between accounting periods if necessary.

Sections 254 to 257: Life assurance business

888. These four sections give effect to allowances for management assets of companies carrying on life assurance business. They are based mainly on section 434D of ICTA. "Management assets" are defined by section 544.

889. The background to the sections is, in summary, that the taxation of life assurance business is complex. It is a trade the profits of which could, and in certain cases must, be charged to tax under Case I of Schedule D. But a company carrying on life assurance business can also be taxed on the investment income of the company, plus capital gains on the investments, with relief given for the company's management expenses. This latter method is known as the "income less expenses" (I-E) basis of assessment.

890. If the I-E basis is chosen, a separate computation must be prepared for each category of life assurance business. The I-E basis itself applies to the income and gains of a company that are referable to its basic life assurance and general annuity business (BLAGAB). Where a company also carries on other categories of life assurance business, it is taxed on the profits of those categories, calculated in the same way as the profits of a trade are calculated, but charged under Case VI of Schedule D. This requirement for separate computations means that allowances have to be identified with each category of business. Section 255 does this. It provides for allowances and charges to be apportioned between categories of business:

- s*ubsection (1)* sets out the basic apportionment formula to be applied, subject to the special rule for overseas life assurance business in subsection (3);
- *subsection (2)* modifies the application of the formula to an overseas life insurance company; and
- *subsection (3)* provides that allowances on assets provided outside the United Kingdom for use in the management of an overseas life assurance business must be allocated to that business.

891. *Section 256* then gives effect to allowances and charges:

- for BLAGAB, subsections (2) and (3) treat allowances as management expenses and charges as income taxable under Case VI of Schedule D;
- for pension, ISA, life reinsurance and overseas life assurance business, subsections (3) and (4) treat allowances and charges as expenses or receipts of that business.

892. *Section 257* deals with various supplementary matters:

- *subsection (1)* ensures that allowances on "management assets" are only given effect in accordance with the special rules in the preceding sections;
- *subsection (2)* preserves the availability of allowances in "notional" computations under Case I of Schedule D, which may have to be prepared even if I-E is chosen as the basis on which tax is charged; and
- *subsection (3)* ensures that the various expressions used in the preceding sections continue to have the same meaning as in the main body of legislation dealing with the taxation of life assurance companies in Chapter I of Part XII of ICTA.

Sections 258 to 261: Special leasing of plant or machinery

893. These four sections give effect to plant and machinery allowances for special leasing. They are based mainly on sections 73, 141 and 145 of CAA 1990. The treatment of special leasing is different partly because there is, by definition, no trade or business (see section 19) and partly because of additional provisions in CAA 1990 for these allowances and charges.

894. *Section 258* for income tax deducts allowances from income from special leasing and taxes charges under Case VI of Schedule D. But this is subject to the restriction in subsection (3). That limits allowances to income from the particular special leasing if the lessee(s) did not use the plant or machinery for a qualifying activity for the whole tax year. Subsection (5) provides for excess allowances to be carried forward and set against future income from special leasing or (if subsection (3) applied) the particular special leasing. But, unlike CAA 1990, the section does not go on to say that tax "shall be discharged or repaid accordingly" as that is unnecessary. See *Note 40* in Annex 2. *Subsection (6)* is based on section 83(1) of CAA 1990. It treats a balancing charge on a special leasing as income so allowances can be set against it. See again *Note 40* in Annex 2.

895. *Sections 259* and*260* make similar provision for corporation tax. The main difference is that the rules for excess allowances are somewhat more complex and so given separately in section 260. The main difference from income tax is that a company has the option to deduct excess allowances from any profits in the same accounting period or carry back them to a previous accounting period (subject to the exception in *subsection (7)*).

896. *Subsection (8)* gives "profits" the meaning in section 6 of ICTA direct – like section 2(4).

897. *Section 261* is based on section 434E(6) of ICTA. It provides that a company carrying on any life assurance business cannot carry back excess allowances from special leasing or set them against other profits of the period or use them for group relief.

Section 262: Employments and offices

898. This section is based on section 27(1) and 140(4) of CAA 1990. It gives effect to allowances and charges in terms of deductions from emoluments and emoluments. This is in place of the terms "receipt" and "expense" in section 140 of CAA 1990. Those terms do not fit employees and office-holders. See *Note 41* in Annex 2.

Chapter 20: Supplementary provisions

Overview

899. This Chapter deals with partnerships and successions in the first six sections and miscellaneous plant and machinery provisions (rules for business entertaining, determination of questions about market value of property and shares in plant or machinery) in the final 3.

900. The partnerships and successions provisions in sections 263 to 268 are based on sections 65, 77 and 78 of CAA 1990.

901. The partnerships and successions provisions in sections 263 to 268 are related to provisions in Chapter 4 of Part 12, and section 343(2) of ICTA. They are also an exception to the general rule in section 15 that qualifying activities must be chargeable to tax.

902. Sections 558 and 559 provide similar rules to sections 263 and 265 for the rest of this Act except Part 6 (research and development).

903. For company reconstructions without a change in ownership section 343(2) of ICTA can apply.

904. Section 560 provides rules on the transfer of an insurance company business which affect all types of capital allowance including plant and machinery.

905. Section 561 deals with transfers of a UK trade between member states. It also applies to plant and machinery and takes priority over all other succession provisions.

Section 263: Qualifying activities carried on in partnership

906. This section is based on section 78(3) and (4) of CAA 1990. It maintains the entitlement to plant and machinery allowances (and liability to balancing charges) of the new partners after a partnership change.

Section 264: Partnership using property of a partner

907. This section is based on section 65(1) and (3) of CAA 1990.

908. Subsections (1) and (2) are based on section 65(1) of CAA 1990 and provide for plant and machinery allowances to be available to a partnership for property owned by one partner.

909. *Subsection (3)* is based on section 65(3) of CAA 1990 and provides an exception for assets leased to the partnership.

910. Section 61(2) stops transfers between partners being disposal events for plant and machinery and is based on section 65(2).

Section 265: Successions: general

911. This section is based on section 78(1) of CAA 1990. It deals with successions to trades which are deemed to be discontinued by either section 113(1) or 337(1) of ICTA.

912. It provides a general rule that if plant or machinery is transferred without sale on the succession to a trade which is deemed to discontinue under section 113(1) or 337(1) of ICTA, then the transfer will be at market value.

913. This rule is of little practical significance to the predecessor because, since 1994, section 113(1) of ICTA will deem there to be a discontinuance only if all the persons carrying on a trade change, so there will normally be an arm's length sale. If there is not a sale then there will be a permanent loss to the old partnership anyway and a disposal event because of section 61(1)(b). There will also be a disposal event because of section 61(1)(f) just because the trade is deemed to be permanently discontinued. Section 61(3) will substitute market value.

914. Similarly the company discontinuance rule in section 337(1) of ICTA will trigger a disposal event within section 61(1)(f).

915. The rule is useful to the successor however because it clarifies that the property is acquired at market value.

916. *Subsection (1)* states when the section applies and *subsection (2)* deals with the deemed sale at market value. It also clarifies that the successor is deemed to acquire the property at market value as the other leg of the deemed sale.

917. *Subsection (3)* defines "relevant property". Subsection (3)(a) requires that the property has to have been previously owned by the predecessor immediately before the succession. See *Change 30* in Annex 1.

918. *Subsection (4)* denies the successor any right to claim first-year allowances.

919. If the succession is between connected persons then an election to substitute a figure that will lead to no balancing allowance or charge may be available. See section 266 and paragraph 920 below.

Section 266: Election where predecessor and successor are connected persons

920. This section is based on section 77(3), (4), (5), (6) and (8) of CAA 1990. It provides for an election to be made if a trade is transferred between connected persons. The election has to be made by both of the parties to the transfer.

921. *Subsection (1)(b)* refers to "within the charge to tax" without the additional words "in the United Kingdom" used in section 77(3)(b) of CAA 1990. The words are not necessary. Omitting them brings this section into line with the wording used elsewhere in CAA 1990 and ICTA. See *Note 42* in Annex 2.

922. *Subsection (2)* provides for a predecessor and successor to "jointly elect". This is a change of wording from section 77 of CAA 1990. See *Note 43* in Annex 2.

Section 267: Effect of election

923. This section is based on section 77(4) and (7) of CAA 1990. It gives the effect of the election. The property is deemed to be transferred at a price which gives rise to neither a balancing charge nor a balancing allowance.

924. For the chargeable period in which a qualifying activity is discontinued (the "final chargeable period"), there can be no writing-down allowance (see section 55(4)) so this value will be the amount left in the pool at the end of the previous chargeable period. The predecessor will not get allowances for the period of transfer.

925. *Subsection (2)(a)* provides for a sale to be treated as occurring when the succession takes place. This is not explicit in section 77(4) of CAA 1990. See *Change 31* in Annex 1

Section 268: Successions by beneficiaries

926. This section is based on section 78(2) and (2A) of CAA 1990. It applies to a beneficiary of a deceased person who succeeds to a qualifying activity under a will or intestacy and acquires plant or machinery as part of the succession. It permits the beneficiary to make an election to treat the transfer as being at the lower of either market value or the amount left in the pool. It also treats the plant or machinery as if it was sold to the beneficiary when the succession takes place.

Section 269: Use of plant or machinery for business entertainment

927. This section is based on section 577 of ICTA. It prevents entitlement to plant and machinery allowances if an asset is used for business entertainment.

928. The section makes it explicit that the restriction applies to qualifying activities. Section 577 of ICTA applies to trades, and in CAA 1990 all types of qualifying activities are deemed to be trades. This is a consequence of the introduction of the term qualifying activity to replace deemed trades.

Section 270: Shares in plant or machinery

929. This section is based on section 83(4) of CAA 1990. It provides for plant and machinery allowances for shares in plant or machinery.

Part 3: Industrial buildings allowances

Overview

930. This Part provides for industrial buildings allowances. These may be writing-down allowances or balancing allowances – or, exceptionally, initial allowances. It also provides for balancing charges. Allowances are, broadly, available if there is qualifying expenditure on a building which is an industrial building. The main type of industrial building is one in use for manufacturing or processing. Only persons with the relevant interest in the building can claim allowances on qualifying expenditure.

931. Chapter 1 deals with the basic requirements for allowances. It defines "industrial building". "Building" is short for "building or structure".

932. Chapter 2 deals with what is and is not an industrial building. The main kind of industrial building is one in use for the purposes of a qualifying trade.

933. Chapter 3 defines the "relevant interest" in relation to the construction expenditure on the building.

934. Chapter 4 defines "qualifying expenditure" and "qualifying enterprise zone expenditure".

935. Chapter 5 contains the conditions for initial allowances. They are available at a rate of 100% to persons who incur qualifying enterprise zone expenditure and meet certain conditions.

936. Chapter 6 contains the conditions for writing-down allowances.

937. Chapter 7 provides for balancing allowances and balancing charges following a balancing event.

938. Chapter 8 sets out how and when qualifying expenditure is written-off.

939. Chapter 9 contains special rules for highway undertakings and highway concessions.

940. Chapter 10 contains special provisions relating to additional VAT liabilities and rebates under the VAT capital goods scheme.

941. Chapter 11 provides for allowances and charges to be given effect.

942. Chapter 12 makes supplementary provisions.

Background

943. The broad theme underlying the legislation is to give relief for capital expenditure on a new building provided that the building is used in particular ways – mainly for manufacturing or processing.

944. There are significant differences from the provisions for plant and machinery allowances in Part 2 of this Act. For example:

- there is normally a single amount of qualifying expenditure, allowances on which may be shared between successive "owners" of the building;
- expenditure is not "pooled" for the purposes of working out allowances and charges;
- writing-down allowances are made on what is generally known as a "straight line" basis. See paragraph 27 above; and
- balancing adjustments are not normally made more than 25 years after the first use of the building.

History

945. Allowances for mills, factories and similar premises were made from 1878 until the Income Tax Act 1945 introduced allowances for capital expenditure on new industrial buildings. There were initial allowances at 10% and writing-down allowances at 2%. A balancing adjustment which could be an allowance or a charge, was made when the asset was sold or destroyed. This broadly meant tax relief was equal to the actual depreciation over the period of ownership. Since then the main changes with enduring effect are that:

- FA 1978 extended allowances to qualifying hotels;

- FA 1980 introduced special provisions for buildings in enterprise zones with initial allowances at 100% and writing-down allowances at 25%. Commercial buildings such as offices also qualified for these allowances;
- FA 1994 introduced provisions to prevent abuse of enterprise zone allowances; and
- FA 1995 replaced toll road undertakings by highway concessions.

946. This list excludes relief for regional projects under legislation which applied only until the mid 1980s. FA 1984 made transitional provisions for the withdrawal of relief. Section 2 of CAA 1990 consolidated those provisions. But enquiries show that no claims could in practice now be made under the legislation referred to in that section. So it is unnecessary to preserve the effect of section 2 in this Act.

Chapter 1: Introduction

Overview

947. This Chapter introduces industrial buildings allowances.

948. Section 271 sets out the basic requirements for industrial buildings allowances and who gets them. It defines "industrial building".

949. Section 272 identifies some expenditure which is regarded as expenditure on the construction of a building and some which is not.

950. Section 273 provides for some expenditure on preparation of a site for plant or machinery to be treated as expenditure on the construction of a building.

Section 271: Industrial buildings allowances

951. This section is based mainly on parts of sections 1, 3, 6, 7, 10, 10A, 10B and 14 of CAA 1990. It sets out the basic requirements for industrial buildings allowances.

952. *Subsection (1)* identifies four types of building which can be classified as an industrial building or structure. This allows *subsection (2)* to define "industrial building". It also provides that in Part 3 "building" is short for "building or structure".

Section 272: Expenditure on the construction of a building

953. This section is based on sections 21(1) and 12 of CAA 1990. It provides that construction expenditure:

- excludes any expenditure on land or rights to land; and
- includes expenditure on repairs to a part of the building if not relieved as a revenue deduction.

Section 273: Preparation of sites for plant or machinery

954. This section is based on section 13 of CAA 1990. Its effect is to give industrial buildings allowances for certain expenditure on preparing land for plant or machinery.

955. *Subsection (2)(a)* is not in section 13 of CAA 1990. But it helps to make clear the effect of the legislation. See *Note 44* in Annex 2.

Chapter 2: Industrial buildings

Overview

956. This Chapter refines the definition of industrial buildings in section 271(2)(b). So the provisions here determine whether or not a building is an industrial building.

957. Section 274 defines "qualifying trades". These may be trades or undertakings carried on by way of trade. A building used for the purposes of a qualifying trade is an industrial building. See section 271(1)(b)(i).

958. Section 275 provides that some buildings used for the welfare of workers are industrial buildings when used for the purposes of a qualifying trade.

959. Section 276 deals with the case in which part of the trade or undertaking is qualifying and part is not. It provides that a building is an industrial building only if it is in use for the part which qualifies. It also provides that maintenance or repair is not necessarily a qualifying trade.

960. Section 277 provides that some uses of a building do not constitute use for the purposes of a qualifying trade. The main uses are as houses, shops, showrooms, hotels and offices.

961. Section 278 similarly excludes buildings used by more than one licensee unless all the licensees use the building for qualifying trades.

962. Section 279 defines a "qualifying hotel". Section 271(1)(b)(ii) means that these are industrial buildings despite the general exclusion of hotels in section 277.

963. Section 280 defines "qualifying sports pavilions". Section 271(1)(b)(iii) includes these as industrial buildings.

964. Section 281 defines "commercial buildings". A commercial building is an industrial building if qualifying enterprise zone expenditure was incurred on the building (section 271(1)(b)(iv)). Commercial buildings include offices (no matter how they are used) but exclude dwelling-houses.

965. Section 282 provides that buildings outside the United Kingdom in use for a trade are not industrial buildings unless the profits of the trade are assessable under the rules of Case I of Schedule D.

966. Section 283 provides a *de minimis* rule. It ignores the fact that part of a building is not an industrial building if the expenditure on that part is not more than 25% of the total expenditure on the building.

967. Section 284 provides that a road on an industrial estate is an industrial building if the buildings on the estate are mainly industrial buildings. For enterprise zones this extends to business parks and the like which comprise mainly commercial buildings.

968. Section 285 provides that a building which is temporarily not in use is not treated as having ceased altogether to be used. This stops temporary disuse triggering a balancing event. See section 315(1)(d). An industrial building continues to be treated as an industrial building during temporary disuse.

Section 274: Trades and undertakings which are "qualifying trades"

969. This section is based on parts of sections 18(1), (9) and (10) and 21(5AA) of CAA 1990. It defines "qualifying trade". Use for a qualifying trade is the main way buildings qualify as industrial buildings.

970. *Subsection (1)* sets out in Table A seven kinds of qualifying trades and in Table B ten kinds of undertakings which are qualifying trades when carried on by way of trade. The equivalent list in section 18(1) of CAA 1990 starts with "a trade carried on in a mill, factory or other similar premises". This Act does not include this. These words add nothing which is not covered by section 18(1)(e), "a trade which consists in the manufacture of goods or materials or the subjection of goods or materials to any process." Items 1 and 2 of Table A are derived from this. See *Note 45* in Annex 2.

971. Item 7 of Table A contains a definition of "mineral deposits" derived from section 161(2) of CAA 1990 but omits the examples of geothermal energy. They are not needed. See *Note 46* in Annex 2.

972. Item 7 of Table B deals with tunnels and is derived from section 18(1)(c) of CAA 1990 which is subject to section 18(11) of the same Act. There is no provision equivalent to section 18(11) in this Act. See *Note 78* in Annex 2.

973. *Subsection (2)* gives pointers to special rules which apply only to highway undertakings.

Section 275: Building used for welfare of workers

974. This section is based on part of section 18(1) of CAA 1990. It deals with buildings for the welfare of workers.

Section 276: Parts of trades and undertakings

975. This section is based on section 18(2) and (3) of CAA 1990. It deals with cases in which part of a trade or undertaking is qualifying and part is not.

976. *Subsection (1)* gives the general rule. This is that part of a trade can count as a qualifying trade. *Subsection (2)* supplements this general rule by providing that a building must be in use for the part of a trade which does qualify for it to be an industrial building.

977. *Subsection (3)* excludes from qualifying trades what is, broadly speaking, "in-house" maintenance and repair work in a business which is not a qualifying trade.

Section 277: Exclusion of dwelling-houses, retail shops, showrooms, hotels and offices etc.

978. This section is based on sections 18(4) and (9) and 161(2) of CAA 1990. *Subsection (1)* excludes some types of building from being treated as in use for the purposes of a qualifying trade. Normally they are not industrial buildings.

979. *Subsections (2)* to *(4)* make an exception to the general rule in subsection (1) for buildings occupied by or in use for the welfare of employees working foreign plantations or mineral deposits.

980. *Subsection (5)* makes clear that the *de minimis* rule in section 283 takes precedence over the rule in subsection (1).

Section 278: Building used by more than one licensee

981. This section is based on part of section 18(6) of CAA 1990. It excludes buildings used by more than one licensee unless all the licensees use the building for qualifying trades.

982. There is a minor change. Section 18(6) of CAA 1990 applies only to trades. This means a building might fail to qualify as an industrial building because one licensee is carrying on not a trade but an undertaking by way of trade – despite the fact that such undertakings are "qualifying trades". This section removes the anomaly. See *Change 32* in Annex 1.

Section 279: Qualifying hotels

983. This section is based on section 19 of CAA 1990. It defines "qualifying hotel". A qualifying hotel is an industrial building. See section 271(1)(b)(ii).

984. Section 19(1) of CAA 1990 refers to accommodation in "a building or buildings". This Act refers only to "a building". But section 6(c) of the Interpretation Act 1978 provides that, unless there is a clear contrary intention, words in the singular include the plural.

Section 280: Qualifying sports pavilions

985. This section is based on section 14 of CAA 1990. It defines a "qualifying sports pavilion". This is an industrial building. See section 271(1)(b)(iii).

Section 281: Commercial buildings (enterprise zones)

986. This section is based on section 21(5) of CAA 1990. In relation to qualifying enterprise zone expenditure (sections 298 to 301) it defines "commercial building". These are industrial buildings for enterprise zones. See section 271(1)(b)(iv).

Section 282: Buildings outside the United Kingdom

987. This section is based on section 18(13) and (14) of CAA 1990. It provides that a building outside the UK which is used for the purposes of a qualifying trade only qualifies for allowances if the profits of that trade are assessable under Case I of Schedule D.

988. In CAA 1990 this condition applies explicitly to all buildings other than commercial buildings. This section applies it to all buildings including commercial buildings. But commercial buildings are, by definition, in enterprise zones in the United Kingdom so the section does not apply to them in any event.

Section 283: Non-industrial part of building disregarded

989. This section is based on section 18(7) of CAA 1990. It is a *de minimis* rule. Its effect is that allowances are given on all the qualifying expenditure if 25% or less relates to a part of the building which would not otherwise qualify.

990. *Subsection (1)* refers to section 571. That provides that references to a building include references to part of a building. So parts of a building which are used differently need to be looked at separately to see if they are industrial buildings. *Subsection (2)* gives the *de minimis* rule.

Section 284: Roads on industrial estates etc.

991. This section is based on section 18(8) of CAA 1990. It means that roads are industrial buildings if they are on:

- industrial estates where the buildings are mainly industrial buildings; or
- business parks in enterprise zones where the buildings are mainly commercial buildings.

992. There is a minor change. In CAA 1990 this provision applies only for buildings used for qualifying trades. It does not cater for estates with undertakings carried on by way of trade or qualifying hotels. Nor does it cater for commercial buildings in enterprise zones which make up a business park or the like. The section extends industrial buildings allowances to roads on such estates. See *Change 33* in Annex 1.

Section 285: Cessation of use and temporary disuse of building

993. This section is based on section 15(1) of CAA 1990. It ignores temporary disuse of a building so there is no balancing event and any writing-down allowances continue to be given. See section 315 for the definition of "balancing event".

994. Section 317 makes special provision for qualifying hotels which are disused for more than two years.

Chapter 3: The relevant interest in the building

Overview

995. This Chapter defines the "relevant interest" in a building for the purposes of Part 3. Allowances are given to the person who holds the relevant interest in a building. See section 271(3).

996. Section 286 gives the general rule. The relevant interest is the interest in the building held by the person who incurred the construction expenditure on the building.

997. Section 287 deals with cases in which a person becomes entitled to an interest in a building as a result of expenditure on its construction. The interest is treated as acquired when the expenditure was incurred.

998. Section 288 deals with a lease or other subordinate interest created out of the relevant interest.

999. Section 289 deals with a relevant interest which is a lease which is then extinguished. The interest into which it merges becomes the relevant interest.

1000. Sections 290 and 291 allow the creation of a long lease to be treated as if it were a sale of the relevant interest out of which it was created.

Section 286: General rule as to what is the relevant interest

1001. This section is based on section 20(1) and (2) of CAA 1990. It gives the basic definition of "relevant interest" for this Part. It also indicates some of the ways in which that definition may be modified.

Section 287: Interest acquired on completion of construction

1002. This section is based on section 21(2) of CAA 1990. It deals with the case of a person who only gets an interest in a building as a result of incurring expenditure on its construction. For example, a person who incurs expenditure on constructing an industrial building may not get a lease until construction is completed.

1003. There is a minor change. CAA 1990 caters only for the interest the person holds on completion of the building. This could be harsh if there is a gap between completion and the interest being acquired. So this section provides for an interest acquired as a result of completion. See *Change 34* in Annex 1.

Section 288: Effect of creation of subordinate interest

1004. This section is based on part of section 20(3) and section 11(5) of CAA 1990. It deals with the case in which a subordinate interest is created out of an existing relevant interest. The relevant interest remains unchanged. *Subsection (2)* provides a signpost to an exception to this rule at section 290.

Section 289: Merger of leasehold interest

1005. This section is based on part of section 20(3) of CAA 1990. It provides that if the relevant interest is a lease which ends either:

- on being surrendered to the person holding the reversion; or
- by the person holding the lease acquiring the reversion,

then the interest into which the lease has merged is the relevant interest.

Sections 290 and 291: Election to treat grant of lease exceeding 50 years as sale

1006. These two sections are based on section 11 of CAA 1990. They allow a lessor and lessee to elect that a long lease granted out of a relevant interest becomes the relevant interest as if it were a sale of the relevant interest to the lessee. The effect of this is broadly that the lessee rather than the lessor becomes entitled to industrial buildings allowances.

1007. An election is made by way of "notice". See section 577.

Chapter 4: Qualifying expenditure

Overview

1008. This Chapter sets out what is qualifying expenditure for the purposes of Part 3. Allowances under this Part are made in relation to qualifying expenditure.

1009. Section 292 introduces five ways in which expenditure may be qualifying expenditure in this Chapter.

1010. Section 293 defines for the purposes of this Chapter "developer" and "development trade".

1011. Section 294 provides that capital expenditure on the construction of a building is qualifying expenditure if the relevant interest in the building has not been sold or was sold only after its first use.

1012. Section 295 provides qualifying expenditure for the purchase of an unused building if a developer is not involved in the transaction.

1013. Section 296 provides qualifying expenditure for the purchase of an unused building built by a developer.

1014. Section 297 provides qualifying expenditure for a used building purchased from a developer.

1015. Sections 298 to 304 make additional provision for enterprise zones and "qualifying enterprise zone expenditure".

1016. Section 298 sets the time limits for expenditure on the construction of a building in an enterprise zone to be qualifying enterprise zone expenditure. It also defines "enterprise zones" and "EZ building".

1017. Sections 299 and 300 provide that qualifying expenditure under sections 294 to 296 on an EZ building is qualifying enterprise zone expenditure. All construction expenditure must be within the time limit.

1018. Section 301 provides for qualifying expenditure on the purchase of an EZ building within 2 years of its first use.

1019. Sections 302 to 304 deal with cases which would be within section 300 or 301 but for the fact that only part of the expenditure was within the time limit. They provide for part of the qualifying expenditure on its construction to be qualifying enterprise zone expenditure.

Section 292: Meaning of "qualifying expenditure"

1020. This section introduces Chapter 4 and provides signposts to the sections which give qualifying expenditure for the purposes of this Part.

Section 293: Meaning of references to carrying on trade as a developer

1021. This section is based on sections 10(3) and (4) and 10A(9) of CAA 1990. It defines terms used in this Chapter.

Section 294: Capital expenditure on construction of a building

1022. This section is based on parts of sections 1(1), 3(1), 6(1), 10(1)(a) and 10A(2)(a) of CAA 1990. It deals with the straightforward case of capital expenditure incurred on the construction of a building by a person who used the building whether or not the relevant interest was subsequently sold.

Section 295: Purchase of unused building where developer not involved

1023. This section is based on parts of sections 10(1) and 10A(1) and (2) and sections 10(2) and 10A(8) of CAA 1990. It deals with a building sold before it is used. No developer is involved. The qualifying expenditure is the lesser of:

- the price paid; and
- the construction expenditure.

Section 296: Purchase of building which has been sold unused by developer

1024. This section is based on parts of sections 10(1) and (3) and 10A(2) and (9) of CAA 1990. It deals with buildings sold by a developer before being used.

1025. *Subsection (2)* gives the qualifying expenditure if the sale in question is the first sale.

1026. *Subsection (3)* gives the qualifying expenditure if there are previous sales.

Section 297: Purchase of used building from developer

1027. This section is based on section 10(4) and (5) of CAA 1990. If a building is purchased from a developer after it has been first used, this section:

- gives the qualifying expenditure for the buyer; and
- writes off expenditure in respect of the time the developer had the building.

1028. *Subsection (3)* provides that sections 301 and 303 take precedence over this section. These sections only apply to buildings in enterprise zones which are purchased within two years of first use.

Sections 298 to 304: qualifying enterprise zone expenditure

1029. These seven sections identify qualifying enterprise zone expenditure. They draw on the provisions earlier in this Chapter for qualifying expenditure. But they also make special provision for buildings purchased within two years of their first use.

1030. *Section 298* is based on parts of sections 1, 6, 10A and 10B, 17A and 21 of CAA 1990. It sets a time limit on construction expenditure in an enterprise zone. And it defines two terms used in the following sections.

1031. *Section 299* is based on parts of section 10A(1), (2), (8) and (9) of CAA 1990. It provides that qualifying expenditure under section 294 is qualifying enterprise zone expenditure if incurred on the construction of an EZ building within the time limit.

1032. *Section 300* is based on parts of sections 1(1) and 6(1) of CAA 1990. It provides that qualifying expenditure under sections 295 and 296 is qualifying enterprise zone expenditure if the construction expenditure was all incurred within the time limit of an EZ building.

1033. *Section 301* is based on parts of section 10B(1), (2), (4), (5) and (8) of CAA 1990. It provides special rules for an EZ building sold after it has first been used but within two years of that first use. If the conditions in *subsection (1)* are met the sale is treated as a balancing event (see Chapter 7) and the qualifying expenditure is subsequently ignored.

But the purchaser is treated as having incurred qualifying enterprise zone expenditure on an unused building.

1034. *Section 302* is the first of three sections which deal with the situation in which only part of the expenditure incurred on constructing a building comes within the enterprise zone time limit as defined in section 298. It is based on parts of section 10A(1), (3) and (4) and on section 10A(6) of CAA 1990. It deals with the two situations covered by sections 295(1) and 296(1). It provides that part of the qualifying expenditure identified by those sections is qualifying enterprise zone expenditure. It does so by apportioning the qualifying expenditure between the amount of expenditure incurred on the EZ building within the time limit and the total expenditure on the building.

1035. *Section 303* is based on parts of sections 10B(1), (2) and (4) and 10B(6) and (7) of CAA 1990. It is similar to section 301 but deals with cases in which only part of the expenditure on constructing the building is within the enterprise zone time limit as defined in section 298.

1036. *Subsection (4)* sets out the method of calculating that part of the qualifying expenditure which will be qualifying enterprise zone expenditure and that part which will not. It applies if a developer is not involved. (The calculations to be made if a developer is involved are provided by section 304.)

1037. *Section 304* is based on section 10B(8) of CAA 1990. It is similar to section 303 but deals with cases in which a developer is involved.

Chapter 5: Initial Allowances

Overview

1038. This Chapter provides initial allowances for qualifying enterprise zone expenditure on a building which is to be an industrial building occupied by the person who incurred that expenditure or by a qualifying lessee or licensee. In relation to qualifying enterprise zone expenditure "industrial building" includes "commercial buildings" as defined in section 281.

1039. Section 305 provides entitlement to allowances. It defines "qualifying lessees and licensees".

1040. Section 306 provides:

- the amount of the initial allowance is 100% of the qualifying enterprise zone expenditure; and
- the allowance is made for the chargeable period in which the qualifying expenditure is incurred.

1041. Section 307 denies or withdraws allowances if the building is not an industrial building when first used.

1042. Section 308 denies or withdraws allowances if expenditure is met by certain grants.

Section 305: Initial allowances for qualifying enterprise zone expenditure

1043. This section is based on parts of section 1(1), (3) and (4) of CAA 1990. It provides entitlement to initial allowances for qualifying enterprise zone expenditure.

1044. There is a minor change. The section makes clear that initial allowances are available in respect of all commercial buildings in enterprise zones whether or not occupied for the purposes of a trade. See *Change 35* in Annex 1.

Section 306: Amount of initial allowance and period for which allowance made

1045. This section is based on parts of sections 1(1) and 161(2) and on section 1(5) and (10) of CAA 1990. It provides that initial allowances are 100% of the qualifying enterprise zone expenditure but allows a person to claim less than the full amount.

1046. There is a minor change. *Subsection (4)* deals with the case in which expenditure is incurred for the purposes of a trade, profession or vocation which has not yet begun. This rule is needed to identify the chargeable period under subsection (3) in respect of which the initial allowance is to be made. In CAA 1990 this applies only for trades. But the addition of professions and vocations follows logically. See *Change 36* in Annex 1.

Section 307: Building not industrial building when it comes to be used etc.

1047. This section is based on sections 1(6), 10(1)(a) and 10A(2)(a) of CAA 1990. It denies or withdraws initial allowances if a building is not an industrial building when first used.

1048. The need to withdraw allowances arises because section 305 gives entitlement to an initial allowance for a building which "is to be" an industrial building. This means that an initial allowance may be made on the basis of intentions that are not fulfilled.

1049. There is a minor change. *Subsection (4)* applies for both subsection (2) and (3) in this section. In CAA 1990 the equivalent (section 1(6)) applies only for cases within subsection (2) of this section. Cases within subsection (3) would be dealt with under the more general provisions in TMA 1970. See *Change 37* in Annex 1.

Section 308: Grants affecting entitlement to initial allowances

1050. This section is based on section 1(7), (8) and (9) of CAA 1990. It denies or withdraws initial allowances if expenditure is met by certain grants.

1051. *Subsection (6)* provides that the adjustments or assessments required under subsection (5) may be made at any time up to the end of a 3-year period following the end of the chargeable period in which the grant, payment or repayment was made. This caters for the fact that there may be considerable gaps between expenditure and grants, or between grants being made and repaid. The three years it provides to make such adjustments does not displace any other provisions which may allow an assessment or adjustment later.

Chapter 6: Writing-down allowances

Overview

1052. This Chapter provides writing-down allowances. It deals with who is entitled to writing-down allowances and how they are calculated. Writing-down allowances are made for qualifying enterprise zone expenditure and other qualifying expenditure.

1053. Section 309 gives entitlement to a writing-down allowance to the person entitled to the relevant interest at the end of the chargeable period provided the building is at that time an industrial building.

1054. Section 310 gives the basic rule for calculating the amount of a writing-down allowance:

- 4% a year of qualifying expenditure; but
- 25% a year of qualifying enterprise zone expenditure.

1055. Section 311 provides the writing-down allowance due to the purchaser of the relevant interest in an industrial building. The allowance is calculated to write off the residue of the qualifying expenditure after the sale over the remainder of the period of 25 years from the first use of the building. Section 313 defines "the residue of qualifying

expenditure”. It is the amount of qualifying expenditure not yet written off (see Chapter 8).

1056. Section 312 limits the amount of writing-down allowance which can be made for a chargeable period to the residue of expenditure.

Section 309: Entitlement to writing-down allowance

1057. This section is based on section 3(1) of CAA 1990. It sets out the conditions for a writing-down allowance.

1058. There is a minor change. *Subsection (2)* permits a person who is entitled to a writing-down allowance to claim any amount which is less than the amount due. See *Change 38* in Annex 1.

Section 310: Basic rule for calculating amount of allowance

1059. This section is based on section 3(2) and section 6(2) of CAA 1990. It provides the basic rule for the amount of a writing-down allowance.

Section 311: Calculation of amount after sale of relevant interest

1060. This section is based on parts of section 3(2B) and (3) of CAA 1990. It provides the amount of a writing-down allowance after the sale of the relevant interest in a building which is or has been an industrial building. It can also apply after an additional VAT liability or rebate.

1061. The starting point for the calculation is “the residue of qualifying expenditure”. This is defined in section 313 by reference to Chapter 8. The writing-down allowance is then calculated as a fraction of the residue of qualifying expenditure. That fraction is the length of a chargeable period divided by the balance, after the date of the relevant event, of the 25-year period which began when the building was first used. The effect of this is to write off the residue over the remainder of the 25-year period.

Section 312: Allowance limited to residue of qualifying expenditure

1062. This section is based on section 3(4) of CAA 1990. It caps the amount of writing-down allowance for a chargeable period which may be given. This makes sure that allowances do not exceed the qualifying expenditure.

Section 313: Meaning of “the residue of qualifying expenditure”

1063. This section is based on part of section 8(1) of CAA 1990. It defines “the residue of qualifying expenditure” as the amount of qualifying expenditure which has not been written off in accordance with Chapter 8.

Chapter 7: Balancing adjustments

Overview

1064. This Chapter provides for balancing adjustments. These are made on the occurrence of certain events, referred to in this Part as balancing events. A balancing adjustment is either a balancing allowance or a balancing charge.

1065. Section 314 provides for balancing allowances and charges. It also provides that no balancing adjustment is made if a balancing event occurs more than 25 years after first use of the building.

1066. Section 315 sets out the main balancing events and points to provisions which provide other balancing events.

1067. Section 316 identifies the proceeds from balancing events.

1068. Section 317 provides one of the other balancing events mentioned in section 315. It applies if a hotel has ceased to be a qualifying hotel (see section 279) for more than two years.

1069. Sections 318 to 320 state the general rules for calculating a balancing adjustment. The calculation differs according to whether or not the building was used as an industrial building, or for R&D, throughout a person's relevant period of ownership.

1070. Section 318 provides the rule if the building has been so used throughout.

1071. Section 319 provides the rule if a building has not been in such use throughout.

1072. Section 320 limits the amount of a balancing charge to the total allowances made.

1073. Sections 321 to 324 define terms used in section 319.

1074. Sections 325 and 326 restrict balancing allowances if:

- a sale subject to a subordinate interest is made involving connected persons; or
- it appears that the main purpose was to obtain an allowance.

1075. Sections 327 to 331 are concerned with expenditure on the construction of buildings in enterprise zones.

1076. Section 328 provides that a balancing event occurs if capital value is realised on a building. No balancing allowance is made for such an event. And there are special rules for calculating a balancing charge.

1077. Section 329 gives the amount of the capital value attributable to a subordinate interest. This amount is treated in section 328 as the proceeds from the balancing event.

1078. Section 330 provides an exception to section 328. That section does not apply if capital value is realised more than seven years after an agreement was made to incur qualifying expenditure.

1079. Section 331 defines various terms for the purposes of sections 328 to 330.

Section 314: When balancing adjustments are made

1080. This section is based on section 4(1) and (2) of CAA 1990. It provides balancing adjustments for industrial buildings allowances. A balancing adjustment is made on the occurrence of a balancing event. See section 315.

1081. *Subsection (5)* provides a balancing adjustment only for the first balancing event to happen in a period when a building is not an industrial building. This prevents double allowances or charges.

Section 315: Main balancing events

1082. This section is based on parts of sections 4(1) and 161(2) of CAA 1990. It gives the main balancing events for industrial buildings allowances. It also provides signposts to sections within Part 3 which give additional balancing events.

Section 316: Proceeds from main balancing events

1083. This section is based on section 156 of CAA 1990. It gives the proceeds from four of the main balancing events.

Section 317: Balancing event where hotel not qualifying hotel for 2 years

1084. This section is based on part of section 7(1) and sections 6(3) and 7(2) of CAA 1990. It provides an additional balancing event for what was previously a qualifying hotel.

This occurs if for a period of two years it is no longer a qualifying hotel. "Qualifying hotel" is defined in section 279.

1085. *Subsection (1)* sets out the circumstances in which the balancing event arises.

1086. *Subsection (2)* contains provisions for the application of balancing adjustments by treating the event as a sale with proceeds equal to the market value of the building.

1087. *Subsections (3)* and *(4)* provide that the general rule in section 285 about temporary disuse applies for up to two years in which the building is not a qualifying hotel but not beyond that period.

1088. *Subsection (5)* provides that this section does not apply to qualifying enterprise zone expenditure.

Section 318: Building an industrial building etc. throughout

1089. This section is based on section 4(3) and (4) of CAA 1990. It calculates the balancing adjustment if a building has been an industrial building throughout the relevant period of ownership. "The relevant period of ownership" is defined in section 321.

1090. *Subsection (2)* provides a balancing allowance if there are no proceeds from the balancing event or the proceeds are less than the residue of qualifying expenditure before that event. "The residue of qualifying expenditure" is defined in section 313. *Subsection (3)* gives the amount of the balancing allowance.

1091. *Subsection (4)* provides a balancing charge if the proceeds from the balancing event are greater than the residue of qualifying expenditure before that event. *Subsection (5)* gives the amount.

Section 319: Building not an industrial building etc. throughout

1092. This section is based on section 4(5), (6), and (7)(a) and (b) of CAA 1990. It calculates balancing adjustments if a building was at some time during the relevant period of ownership not used as an industrial building or for R&D. "The relevant period of ownership" is defined by section 321.

1093. *Subsections (2)* and *(3)* provide a balancing allowance if the proceeds from a balancing event are less than the starting expenditure and the net allowances made are less than the adjusted net cost of the building. "The starting expenditure" is defined in section 322. "Net allowances" is defined in section 324. "Adjusted net cost" is defined in section 323. The amount of the balancing allowance is the difference between the adjusted net cost of the building and the net allowances made.

1094. *Subsections (4)* and *(5)* provide a balancing charge if the proceeds from the balancing event are equal to or greater than the starting expenditure. The proceeds from a balancing event are given by section 316. The amount of the balancing charge is the net allowances made.

1095. *Subsections (6)* and *(7)* provide a balancing charge if the proceeds from the balancing event are less than the starting expenditure (so subsection (4) does not apply) and the net allowances made are more than the adjusted net cost of the building. The amount of the balancing charge is the difference between the net allowances made and the adjusted net cost of the building.

Section 320: Overall limit on balancing charge

1096. This section is based on part of section 4(10) of CAA 1990. It limits the balancing charge that can be made to the amount of the net allowances.

Section 321: The relevant period of ownership

1097. This section is based on part of section 4(9) of CAA 1990. It defines the "relevant period of ownership". This term is used in sections 318 and 319.

Section 322: Starting expenditure

1098. This section is based on part of section 4(9) of CAA 1990. It defines "starting expenditure" for the purposes of Chapter 7.

1099. *Subsection (2)* makes the starting expenditure equal to qualifying expenditure if the person on whom the balancing adjustment is made is the same person who incurred the qualifying expenditure.

1100. *Subsection (3)* provides that in cases not covered by subsection (2) above the starting expenditure will be the residue of qualifying expenditure at the beginning of the relevant period of ownership. "The residue of qualifying expenditure" is defined in section 313. "The relevant period of ownership" is defined in section 321.

1101. *Subsection (4)* is concerned with cases which fall within section 340. These are cases involving the demolition of a building if the person in respect of whom the balancing adjustment is made also incurs demolition costs. Under this subsection the starting expenditure is increased by "the net cost of the demolition" which is defined in section 340(3).

Section 323: Adjusted net cost

1102. This section is based on part of section 4(9) of CAA 1990. It defines the "adjusted net cost". It employs the concept of "relevant period of ownership" which is defined by section 321.

Section 324: Net allowances

1103. This section is based on part of section 4(10) of CAA 1990. It defines "net allowances" for the purposes of Chapter 7.

Section 325: Balancing allowances restricted where sale subject to subordinate interest

1104. This section is based on section 5(1), (2), (3) and (5) of CAA 1990. It restricts balancing allowances in two situations involving the sale of the relevant interest in a building which is subject to a subordinate interest:

- *subsection (2)* – if at least two of the three persons involved are connected persons. "Connected persons" are defined in section 575;
- *subsection (3)* – if the sole or main benefit appears to be the obtaining of an allowance under this Part.

1105. *Subsection (4)* provides that in either of these situations the balancing adjustment is calculated with an increase in the net proceeds of the sale.

1106. *Subsection (5)* limits the amount that is added to the proceeds. This prevents subsection (4) imposing a balancing charge.

1107. *Subsection (6)* deals with a variation of the terms on which the subordinate interest is granted prior to the sale of the relevant interest. Anything received in return for that variation is to be treated as a premium under subsection (4). And the rent, if any, is to be taken as the rent payable under the terms applying immediately before the sale of the relevant interest.

1108. *Subsection (7)* provides that the residue of qualifying expenditure after the sale is to be calculated regardless of an adjustment made by this section. "The residue of qualifying expenditure" is defined in section 313.

Section 326: Interpretation of section 325

1109. This section is based on section 5(4) of CAA 1990. It defines terms used in this section and section 325.

Section 327: Capital value provisions: application of provisions

1110. This section is based on parts of section 120(7) and (8) of FA 1994. It introduces the application of sections 328 to 331. These provisions were introduced to prevent abuse of enterprise zone allowances.

Section 328: Balancing adjustment on realisation of capital value

1111. This section is based on sections 4(1)(dd), 4A(1), 5(2A) and (9A)(a) and (b) of CAA 1990. It provides an additional balancing event if capital value is realised in respect of a building which is or has been an industrial building in an enterprise zone. "Capital value" is defined in section 331(1).

1112. *Subsection (2)* prohibits a balancing event within this section from giving rise to a balancing allowance.

1113. *Subsection (3)* provides that the proceeds from the balancing event are to be taken as the amount of capital value realised.

1114. *Subsection (4)* provides two special rules for calculating a balancing adjustment when there is a balancing event under this section.

1115. *Subsection (5)* provides that capital value is realised if capital value is paid in respect of a subordinate interest in land to which the relevant interest in the building is or will be subject. *Subsection (6)* gives the date that capital value is realised as the date that payment is made.

1116. *Subsection (7)* provides that "the amount of capital value realised" in subsection (3) is the capital value that is attributable to the subordinate interest under section 329.

Section 329: Capital value that is attributable to subordinate interest

1117. This section is based on section 4A(2), (4), (5), (6) and (8) of CAA 1990. It identifies what capital value is attributable to a subordinate interest.

Section 330: Exception for payments more than 7 years after agreement

1118. This section is based on section 4A(7), (11) and (12) of CAA 1990. It provides an exception to section 328 for certain payments made more than 7 years after the agreement to incur qualifying expenditure.

1119. *Subsections (1)* and *(2)* set out the circumstances in which the exception applies. And *subsections (3)* and *(4)* set out the circumstances when it does not. The latter are broadly relevant if arrangements are in place which make a disposal certain or substantially more likely.

Section 331: Capital value provisions: interpretation

1120. This section is based on section 4A(3), (9), (10) and (13) of CAA 1990. It defines terms used in the capital value provisions.

1121. *Subsection (1)* refers to section 34 of ICTA. Section 34 of ICTA provides for certain capital sums paid (for example as premiums under a lease) to be treated as rent or profits in the hands of the landlord.

Chapter 8: Writing off qualifying expenditure

Overview

1122. This Chapter provides what qualifying expenditure is written off and when for the purposes of Part 3. How much qualifying expenditure has been written off determines "the residue of qualifying expenditure". This is defined by section 313 as the qualifying expenditure not written off in accordance with this Chapter.

1123. Section 332 introduces this Chapter.

1124. Section 333 writes off an initial allowance when the building is first used.

1125. Section 334 writes off a writing-down allowance at the end of the chargeable period for which it is made. This is taken to be done immediately before any balancing event which occurs at the end of the chargeable period.

1126. Section 335 writes off R&D allowances in the same way as in the previous section.

1127. Section 336 writes off notional writing-down allowances for periods after the first use of a building when it is not an industrial building.

1128. When a relevant interest in a building is sold, section 337 applies to:

- write off balancing allowances; and
- increase the residue of qualifying expenditure if a balancing charge is made.

1129. Section 338 writes off capital value realised if section 328 gives rise to a balancing event.

1130. Section 339 writes off qualifying expenditure if the Crown or a person not within the charge to tax is entitled to the relevant interest in a building.

1131. Section 340 adds net demolition costs to the residue of qualifying expenditure in some circumstances.

Section 332: Introduction

1132. This section is based on part of section 8(1) of CAA 1990. It introduces Chapter 8. There is a minor change in this Chapter which appears in section 335. See *Change 39* in Annex 1.

Section 333: Writing off initial allowances

1133. This section is based on section 8(2)(b) of CAA 1990. Initial allowances are written off when the building is first used.

Section 334: Writing off writing-down allowances

1134. This section is based on section 8(3) and (4) of CAA 1990. It provides for writing off writing-down allowances.

1135. *Subsection (2)* deals with the situation in which a balancing event occurs at the end of a chargeable period. In order to calculate the balancing adjustment any writing-down allowance written off for that chargeable period has to be taken into account in calculating the residue of qualifying expenditure immediately before the event. "Residue of qualifying expenditure" is defined in section 313.

Section 335: Writing off research and development allowances.

1136. This section is based on part of section 8(5) and section 8(6) of CAA 1990. It provides for writing off R&D allowances. It otherwise follows the same rules as for writing-down allowances in section 334.

1137. There is a minor change. As a result of a change in approach in Part 6 of this Act from that in CAA 1990 less qualifying expenditure may be written off by this section. See *Change 39* in Annex 1.

Section 336: Writing off expenditure when building not an industrial building

1138. This section is based on section 8(7) of CAA 1990. It writes off notional writing-down allowances for any time after a building is first used when it is not an industrial building.

Section 337: Writing off or increase of expenditure where balancing adjustment made

1139. This section is based on section 8(9), (10) and (11) of CAA 1990. It adjusts the residue of qualifying expenditure for a balancing adjustment if a building is sold.

1140. If a balancing allowance is made on the sale, *subsection (2)* writes off the excess of the residue of qualifying expenditure before the balancing event over the net proceeds from that event. If there is a balancing charge, *subsection (3)* adds it to the residue of qualifying expenditure at the time of the balancing event.

1141. *Subsection (4)* modifies this rule if a balancing charge is made under section 319(6). This occurs if a building has not been an industrial building throughout a relevant period of ownership and a balancing charge is made on the difference between the net allowances made and the adjusted net cost of the building. In this situation the residue of qualifying expenditure after the balancing event must not exceed the net proceeds from that event.

Section 338: Writing off capital value which has been realised

1142. This section is based on section 8(12B) of CAA 1990. It deals with balancing events under section 328 which concern the realisation of capital value. The amount of that capital value realised is written off at the time of the balancing event.

Section 339: Crown or other person not within the charge to tax entitled to the relevant interest

1143. This section is based on section 8(13) and part of section 8(14) of CAA 1990. It is concerned with writing off qualifying expenditure for buildings which belonged to the Crown or persons not within the charge to tax.

1144. *Subsection (2)* provides that all the rules concerning writing off qualifying expenditure found in sections 331 to 336 are applied to writing-down allowances and balancing adjustments.

1145. The section refers to "a person who is not within the charge to tax" without the additional words "in the United Kingdom" used in section 8(14) of CAA 1990. The words are not necessary. Omitting them brings this section into line with the wording used elsewhere in CAA 1990 and ICTA. See *Note 42* in Annex 2.

Section 340: Treatment of demolition costs

1146. This section is based on section 8(12) of CAA 1990. It applies to a person who, having incurred demolition costs, faces a balancing allowance or balancing charge as a result of a building being demolished. The net cost of the demolition is added to the residue

of qualifying expenditure prior to the demolition. This means the net cost gets tax relief through industrial buildings allowances.

1147. *Subsection (4)* allows the cost of demolition or the net cost of demolition to be treated as expenditure on a replacement property only for the purposes of assured tenancy allowances (Part 10).

Chapter 9: Highway undertakings

Overview

1148. This Chapter makes special provision for highway undertakings and highway concessions.

1149. Section 341 provides that carrying on a highway undertaking is always an "undertaking carried on by way of trade" for the purposes of Part 3. It gives "highway undertaking" the same meaning as in section 274(1) and defines "highway concession".

1150. Section 342 provides that a highway concession is not an interest in the road but can be treated as the relevant interest in relation to expenditure on the road if the person incurring the expenditure was not entitled to an interest in the road.

1151. Section 343 provides a balancing event if the relevant interest is a highway concession which comes to an end and is not treated as extended. It also defines "proceeds" from that event.

1152. Section 344 provides for a concession to be treated as extended if the person entitled to the concession or a connected person takes up a renewed or new concession in the whole or part of the road.

Section 341: Carrying on of highway undertakings

1153. This section is based on section 21(5AA), (5A) and (5B) of CAA 1990. It sets out the special rules that are to apply in Part 3 of this Act to the carrying on of highway undertakings.

1154. *Subsection (1)* makes a highway undertaking an undertaking by way of trade.

Section 342: The relevant interest

1155. This section is based on sections 4(2AB) and 20(5) and (6) of CAA 1990. It sets out how the concept of "the relevant interest" in the building in Chapter 3 is to be applied in the case of a highway concession.

1156. *Subsection (1)* gives the general rule that a highway concession is not regarded as an interest in a road on which construction expenditure has been incurred.

1157. *Subsection (2)* provides an exception to subsection (1). If:

- expenditure has been incurred on the construction of a road by a person; and
- at that time that person holds no interest in the road but instead was entitled to a highway concession over it;

then that highway concession can be treated as the relevant interest in relation to that construction expenditure.

1158. *Subsection (3)* refers to section 344. That section is concerned with a new or renewed concession being treated as an extension of the previous or original concession. This is also to be applied when determining the relevant interest.

Section 343: Balancing adjustment on ending of concession

1159. This section is based on sections 4(1)(da), part of 4(2AA) and 156(e) of CAA 1990. It deals with the balancing adjustment when a highway concession ends.

1160. *Subsection (1)* provides that the ending of a highway concession is a balancing event, unless it is treated as extended. *Subsection (2)* identifies the proceeds from such a balancing event.

Section 344: Cases where highway concession is to be treated as extended

1161. This section is based on section 4(2AB) and part of 4(2AA) of CAA 1990. It treats a highway concession as extended if a renewed or new concession includes the whole or part of the road covered by the previous concession. There is then no balancing event.

Chapter 10: Additional VAT liabilities and rebates

Overview

1162. This Chapter deals with the interaction of the industrial buildings allowances and the VAT capital items legislation.

1163. Section 345 applies for this Chapter definitions in Chapter 2 of Part 12.

1164. Sections 346 to 348 deal with additional VAT liabilities. Broadly they:

- give entitlement to initial allowances if the person was entitled to an initial allowance for qualifying enterprise zone expenditure and the additional VAT is incurred no more than 10 years after the site was included in an enterprise zone; or
- give rise to qualifying expenditure increasing the residue of qualifying expenditure and so increase allowances.

1165. Sections 349 to 351 deal with additional VAT rebates. The rebate:

- reduces the residue of qualifying expenditure (and so reduces allowances); and
- may give rise to a balancing charge.

Section 345: Introduction

1166. This section applies definitions in Chapter 2 of Part 12 for this Chapter.

Section 346: Additional VAT liabilities and initial allowances

1167. This section is based on section 1(1A) and parts of sections 1(5) and 159A(3) of CAA 1990. It provides for initial allowances to be given in respect of additional VAT liabilities incurred in respect of the qualifying expenditure.

1168. *Subsection (1)(a)* provides the main condition – that the original expenditure entitled the person incurring it to an initial allowance in respect of qualifying enterprise zone expenditure.

1169. *Subsection (1)(b)* to *(d)* provides the other conditions that need to be met for an initial allowance to be given.

1170. *Subsection (6)* makes it clear that the person entitled to the initial allowance in respect of the original expenditure need not be the person incurring the additional VAT liability.

1171. Initial allowances may also be due in respect of additional VAT liabilities arising if the original capital expenditure was incurred in the year ended 31 October 1993. This rule is now of limited application and is dealt with in paragraphs 75 to 77 of Schedule 3.

Section 347: Additional VAT liabilities and writing-down allowances

1172. This section is based on section 3(2A) and (2B) and part of section 159A(3) of CAA 1990. It provides the general rule for additional VAT liabilities.

1173. In order to ensure that the additional VAT liability (and increase in the residue of qualifying expenditure) gives rise to increased writing-down allowances, *subsection (3)* provides that the incurring of an additional VAT liability is a relevant event for the purposes of section 311.

Example

In 1998 U incurs qualifying expenditure of £500,000 on an industrial building. In 2003 U incurs an additional VAT liability of £10,000 in respect of the building. At that time the residue of qualifying expenditure is £400,000.

The £10,000 is added to the residue of qualifying expenditure giving a total of £410,000. Section 311 means that (subject to other relevant events) subsequent writing-down allowances must reflect the increased qualifying expenditure.

If from the time the additional VAT liability accrued 20 years remain, (out of the period of 25 years since first use of the building,) the revised writing-down allowance will be £20,500 for each year (£410,000 divided by 20).

Section 348: Additional VAT liabilities and writing off initial allowances

1174. This section is based on section 8(2)(a) and part of section 159A(3) of CAA 1990. It provides that an initial allowance in respect of an additional VAT liability is written off when the additional VAT liability accrues.

1175. Most initial allowances will relate to qualifying enterprise zone expenditure and will be given at 100%. In such cases the residue will be increased by this amount (under section 347(2)(b)) and immediately reduced again by this section.

1176. If a reduced initial allowance is made (or under paragraph 75(3) of Schedule 3 only a 20% initial allowance is available) then the net effect of these two rules is that the residue is increased by the difference between the additional VAT liability incurred and the initial allowance made.

Section 349 and 350: Additional VAT rebates

1177. These sections are based on parts of sections 3, 4 and 159A of CAA 1990. They deal with additional VAT rebates received in respect of qualifying expenditure.

1178. *Section 349* applies when the additional VAT rebate received is less than the residue of qualifying expenditure immediately before the rebate accrues. In such cases, *subsection (2)* provides that writing-down allowances are revised accordingly. Section 351 provides that the residue is first reduced by the amount of the rebate.

1179. *Section 350* applies in all cases when an additional VAT rebate is made. However, it is only relevant if the additional VAT rebate exceeds the residue of qualifying expenditure. *Subsection (1)* provides that the making of the additional VAT rebate is a balancing event. Under section 314, this can give rise to balancing allowances and balancing charges. However, *subsection (2)* provides that no balancing allowance can arise as a result of an additional VAT rebate.

1180. *Subsection (3)* provides that a balancing charge will only arise if the additional VAT rebate exceeds the residue of qualifying expenditure. *Subsection (4)* ensures that the balancing charge is equal to the difference.

1181. *Subsection (5)* deals with starting expenditure. If and only if:

- a balancing charge is made under this section; and

- the person to whom it is made is the person who incurred the qualifying expenditure,

then the starting expenditure is reduced by the amount of the balancing charge.

Section 351: Additional VAT rebates and writing off qualifying expenditure

1182. This section is based on section 8(12A) and part of section 159A(3) of CAA 1990. It provides that the residue of qualifying expenditure is reduced by the amount of any additional VAT rebate made.

Chapter 11: Giving effect to allowances and charges

Overview

1183. This Chapter provides how allowances and charges under Part 3 are given effect.

1184. Section 352 gives the rule for trades. Allowances and charges are treated as expenses and receipts of the trade. The same rule applies for professions and vocations occupying commercial buildings built with qualifying enterprise zone expenditure.

1185. Section 353 deals with buildings which are leased or licensed. The allowances and charges are treated as expenses and receipts of the person's:

- Schedule A business; or
- overseas property business;

as appropriate. If the building is not an asset of any property business then the person is treated as carrying on a Schedule A business and the allowances and charges are given effect in that notional business.

1186. Section 354 provides for allowances and charges for certain buildings temporarily out of use to be given as if they were leased or licensed.

1187. Section 355 contains special rules under which balancing allowances in respect of industrial buildings used for mining may be carried back to earlier chargeable periods.

Section 352: Trades

1188. This section is based on parts of sections 9, 140, 144 and 161 of CAA 1990. It deals with allowances and charges under Part 3 for trades and, for commercial buildings, professions and vocations.

1189. There is a minor change. This is to provide for allowances and charges on commercial buildings to be given effect for professions and vocations. See *Change 36* in Annex 1.

1190. *Subsection (3)* makes clear that the general rule in subsection (1) may be displaced by subsequent provisions.

Section 353: Lessors and licensors

1191. This section is based on sections 9 and 161(2A) of CAA 1990. It gives effect to allowances and charges in respect of an industrial building which is leased or licensed.

1192. Section 9 of CAA 1990 refers only to a Schedule A business. But section 161(2A) means this must be read as including an overseas property business. This section deals with both explicitly. So it gives effect to allowances and charges in the business of which the building is an asset. See *Note 47* in Annex 2.

1193. *Subsection (4)* deals with the case in which this section applies but the person's interest in the building is not an asset of any property business. As in CAA 1990, it provides a notional Schedule A business in which allowances and charges are given effect.

Section 354: Buildings temporarily out of use

1194. This section is based on section 15ZA of CAA 1990. It deals with the way allowances or charges are given effect if there has been temporary disuse of the building but it is still treated as an industrial building.

1195. *Subsection (2)* deals with cases in which a trade is discontinued or the relevant interest was subject to a lease or licence which ends. It provides for section 353(4) to apply so allowances and charges can be given effect.

1196. *Subsection (3)* provides that if:

- liability to a balancing charge arises; and
- the person liable last used the industrial building for the purposes of a trade which has subsequently ceased,

then certain deductions may be made from that balancing charge. The deductions are those allowable under section 105 of ICTA against income from post cessation receipts and so on.

1197. *Subsection (4)* makes clear this does not prevent other deductions.

1198. *Subsection (5)* excludes from this section events which are treated as the permanent discontinuance of a trade by sections 113(1) or 337(1) of ICTA.

1199. *Subsection (6)* provides that in the case of a commercial building (see section 281), the word "trade" includes a profession or vocation. This is a minor change. See *Change 36* in Annex 1.

Section 355: Buildings for miners etc.: carry-back of balancing allowances

1200. This section is based on section 17(1) and (2) of CAA 1990. It provides for balancing allowances in respect of certain mining structures to be carried back to earlier chargeable periods.

Chapter 12: Supplementary provisions

Overview

1201. This Chapter makes various supplementary provisions for Part 3.

1202. Section 356 provides for the apportionment of sale proceeds if only part of the proceeds is in respect of qualifying expenditure.

1203. Section 357 is an anti-avoidance provision directed against arrangements which distort pricing.

1204. Section 358 deals with certain land requisitioned by the Crown.

1205. Section 359 provides rules for when a lease comes to an end.

1206. Section 360 defines "lease" and related terms.

Section 356: Apportionment of sums partly referable to non-qualifying assets

1207. This section is based on section 21(3) of CAA 1990. It is an additional provision over and above those in Part 12 which apportion sale proceeds between different property. It apportions the proceeds if there is a sale of the relevant interest in a building and only some of the assets represent qualifying expenditure.

1208. There is a minor change. Section 21(3) of CAA 1990 refers to an amount which "on a just apportionment is attributable to assets…". *Subsection (1)* uses the words "on a just

and reasonable apportionment is attributable to assets…". In practice this should not make any difference to the outcome of an apportionment. See *Change 40* in Annex 1.

1209. *Subsection (2)* makes clear that this applies not only on the sale of the relevant interest in a building but also to other balancing events which give rise to proceeds. See sections 315 and 316.

Section 357: Arrangements having an artificial effect on pricing

1210. This section is based on sections 10D and 151(1A) of CAA 1990. It deals with arrangements which have an artificial effect on pricing.

1211. *Subsection (1)* is directed at the sale of a relevant interest at an artificially inflated price. In order to determine qualifying expenditure that price is, broadly speaking, reduced to what it would have been in the absence of the arrangements which had an artificial effect.

1212. *Subsection (2)* deals similarly with the proceeds from a sale at an artificially inflated price.

Section 358: Requisitioned land

1213. This section is based on section 16(1), (2) and (3) of CAA 1990. It treats a person who is legitimately occupying and trading on requisitioned land as holding an interest in that land.

1214. *Subsection (1)* applies this section for the "period of requisition" when compensation for requisitioned land would be payable under section 2(1)(a) of the Compensation (Defence) Act 1939. It does not matter whether or not agreement has been reached concerning the compensation payable.

1215. *Subsection (2)* provides that for the period of requisition of land by the Crown it is as if the Crown were in possession of the land under a lease.

1216. *Subsection (3)* is concerned with a person who is authorised by the Crown to occupy any part of the land and carries on a trade during the period of requisition. That person is to be treated as holding a sublease of the land from the Crown.

1217. *Subsection (4)* provides that the lease mentioned in subsection (2) or the sublease in subsection (3) is to be regarded as falling within the appropriate provisions of this Part.

1218. *Subsection (5)* deals with a person entitled to the land, who makes a payment in respect of a building constructed on the land during the period of requisition. If the payment is made to the Crown, it is to be treated as in consideration of the surrender of the lease. If the payment is made in accordance with subsection (3) to the occupier, then it is to be treated as the surrender of the sublease.

Section 359: Provision applying on termination of lease

1219. This section is based on section 16(4), (5), (6) and (7) of CAA 1990. It is of general application to this Part whenever a lease is terminated.

Section 360: Meaning of "lease" etc.

1220. This section is based on parts of sections 4A(13), 161(2) and 162 of CAA 1990. It defines terms for Part 3.

Part 4: Agricultural buildings allowances

Overview

1221. This Part provides for agricultural buildings allowances. These may be writing-down allowances or balancing allowances. It also provides for balancing charges.

1222. Chapter 1 makes allowances available if qualifying expenditure has been incurred on the construction of a building for the purposes of husbandry. The person incurring the expenditure must have an interest in the related agricultural land. The first use of the building must be for husbandry.

1223. Chapter 2 defines the “relevant interest”. Allowances are given to the person holding the relevant interest.

1224. Chapter 3 defines “qualifying expenditure” for the purposes of agricultural buildings allowances.

1225. Chapter 4 provides entitlement to writing-down allowances. These are generally at 4% a year of the qualifying expenditure.

1226. Chapter 5 provides for balancing allowances and balancing charges if the relevant interest in the related agricultural land is transferred or the agricultural building is destroyed.

1227. Chapter 6 gives effect to allowances and charges.

Background

1228. The principal theme underlying the legislation is to give relief for capital expenditure incurred on the construction of buildings and structures for the purposes of husbandry. To do this the legislation needs to identify:
   - what expenditure qualifies for capital allowances;
   - who gets the allowances; and
   - how much relief is given.

History

1229. ITA 1945 introduced capital allowances for capital expenditure on the construction of agricultural and forestry buildings and works. Allowances were given at 10% a year for ten years to the owner or tenant of agricultural or forestry land. There were no balancing adjustments.

1230. Capital allowances generally were not, and still are not, available for expenditure on dwelling-houses. But allowances were given on expenditure on farmhouses (up to one third of the expenditure) and on cottages.

1231. FA 1978 introduced initial allowances at 20%.

1232. As part of a wider reform of business taxation, FA 1985 abolished initial allowances. It also reduced writing-down allowances to 4% a year.

1233. FA 1986 introduced a new system of agricultural buildings allowances. This included balancing adjustments. Balancing allowances gave an option of accelerated relief if a building or work was demolished or destroyed. It also introduced two special conditions. No allowances are given to a person who sells the agricultural land before the building has been brought into first use. And no allowances are given if the first use of the building is not for husbandry.

1234. FA 1988 abolished allowances for forestry buildings and works. This was part of a general reform which took the profits, gains and losses of forestry out of the tax system.

1235. The legislation was consolidated as Part V of CAA 1990.

1236. As a temporary measure FA 1993 introduced initial allowances of 20% for expenditure incurred under contracts from November 1992 to October 1993.

Structure of Part 4

1237. The legislation at Part V of CAA 1990 has some similarity with Part I of CAA 1990 (industrial buildings allowances). Both give allowances:

- for capital expenditure incurred on the construction of buildings;
- to the person with the relevant interest; and
- on a "straight line basis" (see paragraph 27 above).

1238. But there are also important differences. In particular, for industrial buildings the focus is on the use of the building for the trade or undertaking. For agricultural buildings the focus is on land used for the purposes of husbandry in respect of which the construction expenditure was originally incurred.

Chapter 1: Introduction

Overview

1239. Chapter 1 outlines the conditions for agricultural buildings allowances and the persons who may claim them. It introduces some of the terms employed subsequently in Part 4.

1240. Section 361 sets out the basic requirements and defines two key terms used in Part 4, "agricultural building" and "the related agricultural land".

1241. Section 362 defines "husbandry" to include intensive farming and the cultivation of short rotation coppice.

1242. Section 363 excludes expenditure on land from agricultural buildings allowances.

Section 361: Agricultural buildings allowances

1243. This section is based on parts of sections 123, 124(1), 125(1) and section 133(1) of CAA 1990. It sets out the basic conditions for agricultural buildings allowances.

1244. *Subsection (1)*:

- includes a minor change. This is to avoid the use of "farm buildings" which does not capture accurately the fact that agricultural buildings allowances are given also for such things as short rotation coppicing. See *Change 41* in Annex 1; and
- refers to "land in the United Kingdom" instead of "agricultural land" which CAA 1990 goes on to define as "land, houses or other buildings in the United Kingdom". This is simpler because the Interpretation Act 1978 gives "land" a meaning which includes buildings in any event. See *Note 48* in Annex 2.

1245. *Subsection (2)* gives the meanings of two terms used in Part 4. "The related agricultural land" is an important concept in determining who is entitled to agricultural buildings allowances at any given time. Broadly speaking, allowances go with the related agricultural land.

1246. *Subsection (3)* provides that the person who has the relevant interest in relation to the qualifying expenditure is entitled to allowances. "Relevant interest" is explained in Chapter 2 and "qualifying expenditure" in Chapter 3.

Section 362: Meaning of "husbandry"

1247. This section is based on parts of section 133(1) of CAA 1990 and of section 154(1) and (3) of FA 1995. It widens the meaning of "husbandry".

1248. The meaning of "husbandry" has been examined by the courts on several occasions over the years. Other words which might appear more user-friendly, for example "farming" or "agriculture", could not be used without changing the scope of agricultural buildings allowances in ways which would be uncertain.

1249. Section 154(1) of FA 1995 provides that for the purposes of the Tax Acts and the Taxation of Chargeable Gains Act 1992 the cultivation of short rotation coppice is to be regarded as farming, husbandry or agriculture but not as forestry. Agricultural buildings allowances make use of the definition in section 154(3) of FA 1995:

> ""short rotation coppice" means a perennial crop of tree species planted at high density, the stems of which are harvested above ground level at intervals of less than ten years.

Section 363: Expenditure on the construction of a building

1250. This section is based on section 133(6) of CAA 1990. It excludes from agricultural buildings allowances expenditure on the acquisition of land or of rights in or over land. As in other Parts, allowances are only given for what depreciates – in this case expenditure on the construction of a building.

Chapter 2: The relevant interest

Overview

1251. Chapter 2 identifies the relevant interest in relation to qualifying expenditure in various situations.

1252. Section 364 is the general rule. The relevant interest is the freehold or leasehold in the related agricultural land. The owner or tenant must have incurred expenditure on constructing an agricultural building.

1253. Section 365 provides that the relevant interest does not change because of the creation of a subordinate interest. Section 366 deals with the effect of assigning or conveying an interest in land as a security to a creditor, a practical point only in Northern Ireland.

1254. Section 367 identifies the relevant interest if a leasehold interest merges with another interest. Section 368 deals with other situations in which a lease comes to an end.

Section 364: General rule as to what is the relevant interest

1255. This section is based on sections 125(2) and (3) of CAA 1990. It identifies the relevant interest in terms of the freehold or leasehold interest in the related agricultural land.

1256. In CAA 1990 this is done less directly. Section 125 of CAA 1990 first defines a "major interest". The "relevant interest" is then defined as the particular major interest in the agricultural land which was held by the person at the time they incurred expenditure on the agricultural building.

1257. The concept of "the relevant interest" is similar to that for industrial buildings allowances. But it is not the same. In particular for agricultural buildings allowances the relevant interest is not in the building but in the related agricultural land.

Section 365: Effect of creation of subordinate lease

1258. This section is based on part of section 125(4) of CAA 1990. It provides that the creation of a subordinate lease has no effect on the relevant interest.

Section 366: Interest held as security

1259. This section is based on section 133(4) of CAA 1990. It ensures that a person who, for example, mortgages land, continues to have the relevant interest in circumstances which in Northern Ireland may involve a conveyance or assignment. See the commentary on section 175, paragraph 646646 above.

Section 367: Merger of leasehold interest

1260. This section is based on sections 125(4) and 126(4) of CAA 1990. It deals with a relevant interest which is a lease. It sets out rules to determine what happens to the relevant interest when the lease comes to an end.

1261. *Subsection (1)* provides that the reversionary interest (for example the freehold in a simple case) becomes the relevant interest if:

- a lease is extinguished on surrender to the holder of the reversionary interest; or
- the holder of the lease acquires the reversionary interest.

1262. *Subsection (2)* provides an additional rule if a different person owns the relevant interest as a result of subsection (1). The new owner is treated as having acquired the relevant interest. This gives the new owner the right allowances.

1263. *Subsection (3)* excludes from this section the cases dealt with in section 368.

Section 368: Provisions applying on ending of lease

1264. This section is based on section 126(5) of CAA 1990. It deals with three other cases involving the ending of a lease.

1265. *Subsection (2)* applies if the same lessee gets a new lease of the whole or part of the related agricultural land. Then the lessee keeps the relevant interest.

1266. *Subsection (3)* applies if a new (incoming) lessee:

- gets a new lease of whole or part of the related agricultural land; and
- pays the outgoing lessee for agricultural buildings on which qualifying expenditure had been incurred.

1267. The new lessee is then treated as having acquired the relevant interest in the whole of the related agricultural land. This links with section 375 which deals with the calculation of allowances after acquisition of a relevant interest.

1268. There is a minor change. Subsections (2) and (3) go further than section 126 of CAA 1990 by catering for cases in which the new lease is for part of the land as well as those in which the new lease is for all of the land. See *Change 42* in Annex 1.

1269. *Subsection (4)* applies in other cases. The relevant interest is treated as acquired by the lessor.

Chapter 3: Qualifying expenditure

Overview

1270. This Chapter identifies qualifying expenditure for the purposes of Part 4.

1271. Section 369 gives the general rule about capital expenditure incurred on the construction of an agricultural building which is not sold before it was first used. Broadly, the capital expenditure is qualifying expenditure. It also provides special rules for farmhouses and for buildings only partly used for the purposes of husbandry.

1272. Section 370 deals with expenditure on buildings if the relevant interest is sold before first use of the building. Broadly, the lesser of the construction expenditure and the price paid is qualifying expenditure.

1273. Section 371 apportions expenditure if a person has different relevant interests in different parts of the related agricultural land.

Section 369: Capital expenditure on construction of agricultural building

1274. This section is based on parts of sections 123 and 124(1) of CAA 1990. It gives the general rule for what is qualifying expenditure for the purposes of agricultural buildings allowances. It also:

- restricts the expenditure on farm houses which can be qualifying expenditure; and
- caters for expenditure on buildings which are only partly for use on the related agricultural land.

1275. There is a minor change. The section provides for a "just and reasonable apportionment". CAA 1990 provides for a "just apportionment". See *Change 40* in Annex 1.

Section 370: Purchase of relevant interest before first use of agricultural building

1276. This section is based mainly on parts of sections 123 and 127 of CAA 1990. It deals with expenditure which would have been qualifying expenditure but for a sale of the relevant interest before the building was first used. The qualifying expenditure is then broadly the lesser of:

- the capital expenditure which would have been the qualifying expenditure for the person who incurred it; and
- the expenditure paid by the buyer in respect of the building.

1277. There is a minor change in *subsection (1)*. It gives the buyer qualifying expenditure only if a capital sum is paid for the relevant interest. CAA 1990 does not require the sum to be capital. See *Change 43* in Annex 1.

1278. *Subsection (3)* provides that:

- expenditure which is excluded from qualifying expenditure by section 369(3) to (5) is also excluded for the purpose of this section; and
- a just and reasonable apportionment must be made of the purchase price as between the building and other things (for example land). There is a minor change. It is the use of "just and reasonable apportionment" whereas CAA 1990 uses "just apportionment". See *Change 40* in Annex 1.

Section 371: Different relevant interests in different parts of the related agricultural land

1279. This section caters for a person who incurs qualifying expenditure on the construction of a building but who has different relevant interests in different parts of the related agricultural land. The expenditure is apportioned between the different parts.

1280. There is nothing corresponding to this in CAA 1990. But this Act differs from CAA 1990. It allows in section 361 for expenditure incurred for husbandry on land made up of several relevant interests in the related agricultural land. This provision follows through the consequences of that. See *Note 49* in Annex 2.

Chapter 4: Writing-down allowances

Overview

1281. This Chapter identifies who is entitled to writing-down allowances when and in what amount.

1282. Sections 372 and 373 give the general rules. Writing-down allowances are made to whoever holds the relevant interest. Allowances are made at 4% a year over a 25-year period. This is referred to as the writing-down period.

1283. Section 374 withdraws allowances if the building's first use is not for husbandry.

1284. Sections 375 and 376 deal with transfers of the relevant interest after first use of a building. Section 375 gives the new owner entitlement to writing-down allowances. Section 376 sets out the rules for calculating the new owner's allowances.

1285. Section 377 stops writing-down allowances being given if there is a balancing adjustment in a chargeable period.

1286. Sections 378 and 379 ensure that allowances do not exceed the qualifying expenditure and, conversely, that the final writing-down allowance does not leave some qualifying expenditure incapable of being used.

Section 372: Entitlement to writing-down allowance

1287. This section is based on section 123 of CAA 1990. It gives the general rule for entitlement to writing-down allowances.

1288. There is a minor change. *Subsection (3)* allows a person to claim less than full entitlement to a writing-down allowance. See *Change 38* in Annex 1.

Section 373: Basic rule for calculating amount of allowance

1289. This section is based on parts of sections 123 and 126(2) of CAA 1990. It gives the 4% rate for agricultural buildings allowances.

Section 374: First use of building not for purposes of husbandry etc.

1290. This section is based on section 124(2) of CAA 1990. It deals with buildings if the first use is not for husbandry. Writing-down allowances are not then available. Any allowances previously given are withdrawn.

Section 375: Effect of acquisition of relevant interest after first use of building

1291. This section is based on section 126(1), (2) and (3) of CAA 1990. It deals with transfers of a relevant interest after a building has been used.

1292. Entitlement to allowances then passes to the new owner. If the relevant interest in only part of the related agricultural land changes hands, succession to allowances is confined to those which are specific to that part of the land.

Section 376: Calculation of allowance after acquisition

1293. This section is mainly based on section 129(1) and (3) of CAA 1990. It provides the rate of writing-down allowances after a balancing event so the new owner gets the right total allowances over the remainder of the writing-down period. The "writing-down period" is defined by section 372(2).

1294. *Subsections (1)* and *(2)* give the rules for recalculating writing-down allowances. These apply if there is a balancing event and an election for a balancing adjustment. The residue of qualifying expenditure is spread over the remaining period.

1295. *Subsection (6)* adjusts the writing-down allowance for any chargeable period in which the relevant interest is not held throughout. This is the same rule as in section 375(4)(b).

Section 377: Chargeable period when balancing adjustment made

1296. This section is based on part of section 128(1) of CAA 1990. It stops people getting writing-down allowances for the same chargeable period for which they get a balancing adjustment. Balancing adjustments are dealt with in Chapter 5.

Section 378: Allowance limited to residue of qualifying expenditure

1297. This section is based on section 146(2) and (3) of CAA 1990. It limits the amount of a writing-down allowance for a chargeable period to the residue of qualifying expenditure immediately prior to the allowance being made. This makes sure the total allowances do not exceed the qualifying expenditure.

Section 379: Final writing-down allowance

1298. This section is based on section 126(6) of CAA 1990. It makes sure the owner of the relevant interest at the end of the writing-down period gets the full entitlement to allowances on the assumptions in subsection (3). Its effect is to "catch up" any allowances lost solely as a result of the way the rules for giving allowances on a transfer operate.

Chapter 5: Balancing adjustments

Overview

1299. This Chapter provides balancing adjustments. These are only made if there is an election for a balancing adjustment:

- on a sale, by both buyer and seller; or
- on the destruction or demolition of a building, by the owner.

1300. A balancing adjustment is either a balancing allowance or a balancing charge depending on whether the residue of qualifying expenditure is more or less than the proceeds from the balancing event.

1301. Section 380 gives the basic rules for when a balancing adjustment is made and how.

1302. Section 381 defines events which are balancing events if an election is made. Section 382 provides how elections are made.

1303. Sections 383 and 384 give the proceeds from a balancing event.

1304. Section 385 gives the basic rule for the calculation of a balancing adjustment. It is the difference between the proceeds and the residue of qualifying expenditure.

1305. Section 386 defines "the residue of qualifying expenditure". It is broadly the net amount of qualifying expenditure not yet relieved.

1306. Section 387 caps a balancing charge at the amount of allowances previously given.

1307. Section 388 provides for balancing events in relation to part of a building or part of the related agricultural land.

1308. Sections 389 and 390 restrict balancing allowances in certain transactions involving connected persons or if allowances are the sole or main benefit.

Section 380: When balancing adjustments are made

1309. This section is based on section 128(1) of CAA 1990. It provides for balancing allowances and charges for agricultural buildings allowances if there is:

- qualifying expenditure; and
- a balancing event in the writing-down period.

1310. A balancing adjustment allowance or charge is made for the chargeable period in which the balancing event occurs, to or on the person who has the relevant interest in relation to the qualifying expenditure prior to the balancing event.

Section 381: Balancing events (on making an election)

1311. This section is based on parts of section 129(1) and (2) of CAA 1990. It defines "balancing events".

1312. There is a minor change. Section 129(1)(b) refers to an agricultural building which "otherwise ceases to exist as such". In *subsection (2)(c)* of this section the corresponding words are "the agricultural building ceases altogether to be used (without being demolished or destroyed)". This provides a link to the provisions which define the "proceeds" from such an event. CAA 1990 has no such link. See *Change 44* in Annex 1.

Section 382: Requirements as to elections

1313. This section is based on section 129(2), (4) and (5) of CAA 1990. It sets out how elections for balancing events must be made. In general this is by the old and new owners jointly.

1314. *Subsections (2)* and *(3)* prevent an election from being made if the sole or main benefit of the transaction(s) which gave rise to the balancing event is obtaining an allowance or an increased allowance.

1315. *Subsection (4)* provides for an election to be made by the person entitled to the relevant interest immediately before the event if there is no new owner.

1316. *Subsection (5)* prevents people from making an election if they are not "within the charge to tax" without the additional words "within the charge to tax in the United Kingdom" which are in section 129(5) of CAA 1990. The words are not necessary. Omitting them brings this section into line with the wording used elsewhere in CAA 1990 and ICTA. See *Note 42* in Annex 2.

1317. *Subsections (6)* and *(7)* set the time limits for making an election for both income tax and corporation tax purposes. These are the normal self assessment time limits.

Section 383: Proceeds from balancing events

1318. This section is based on parts of sections 128(2) and 156 of CAA 1990. It defines the "proceeds from balancing events".

1319. *Subsection (1)* brings together material from sections 128(2)(b) and 156 of CAA 1990 in a Table linking each of the balancing events from section 381(2) to the proceeds. The third item in the Table follows from the minor change in section 381(2)(c). See *Change 44* in Annex 1.

1320. *Subsection (2)* makes clear the proceeds from an event are those received or receivable by the person who has liability to the charge or entitlement to the allowance.

Section 384: Exclusion of proportion of proceeds

1321. This section is based on sections 128(3) and 133(7) of CAA 1990. It apportions the proceeds from a balancing event to take account of:

- other assets (for example land); and
- expenditure excluded from qualifying expenditure (for example on a farmhouse).

1322. *Subsection (1)* is based on part of section 133(7) of CAA 1990. If part of the proceeds from a balancing event do not relate to assets representing qualifying expenditure, a just and reasonable apportionment must be made to establish the correct amount under column 2 of the Table in section 383 subsection (1). This can arise if, for example, part of the proceeds is attributable to land. There is a minor change in the use of "just and reasonable" in place of "just". See *Change 40* in Annex 1.

1323. *Subsection (2)* is based on section 128(3) of CAA 1990. It deals with expenditure on farmhouses and on buildings only partly used for husbandry. Only part of that expenditure qualifies for agricultural buildings allowances. So disposal proceeds for such buildings must be restricted in the same proportion as was applied to the expenditure. This subsection does this.

1324. *Subsection (3)* is based on the opening words of section 133(7) of CAA 1990. It makes clear this section does not stop the general provisions for apportionments applying in these circumstances.

Section 385: Calculation of balancing adjustment

1325. This section is based on section 128(4) and (5) of CAA 1990. It calculates a balancing adjustment. The calculation uses "the proceeds from the balancing event" from sections 383 and 384 and "the residue of qualifying expenditure" from section 386.

Section 386: The residue of qualifying expenditure

1326. This section is based on part of section 128(2) of CAA 1990. It defines the "residue of qualifying expenditure".

1327. The calculation of the residue is defined in a different way from that used in section 128(2)(a) of CAA 1990. See *Change 45* in Annex 2.

Section 387: Overall limit on balancing charge

1328. This section is based on section 128(6) of CAA 1990. It puts a cap on a balancing charge. It cannot exceed the allowances made.

1329. There is a minor change. The reference to "chargeable periods ending before the balancing event" makes explicit just which allowances are to be taken into account. See *Change 46* in Annex 1.

Section 388: Acquisition of relevant interest in part of land, etc.

1330. This section is based on section 128(7) of CAA 1990. It deals with balancing events for part of the related land or part of an agricultural building.

1331. *Subsection (1)* applies the section to balancing events under:

- section 381(2)(a) if a new owner acquires part of the relevant interest in the related agricultural land; and
- section 381(2)(b) and (c) if part of an agricultural building is demolished, destroyed or ceases to be used.

1332. *Subsection (2)* provides the apportionment rule. The balancing adjustment is to be calculated by reference to the relevant part of the qualifying expenditure.

1333. *Subsection (3)* makes clear that section 377 applies. The effect is that no writing-down allowance is due for the chargeable period of the balancing event in respect of the part of the qualifying expenditure for which there is a balancing adjustment.

Section 389: Balancing allowances restricted where sale subject to subordinate interest etc.

1334. This section is based on section 130(1), (2), (3) and (5) of CAA 1990. It stops sales of relevant interests which are subject to a subordinate interest being used to create balancing allowances. It is an anti-avoidance rule.

1335. *Subsections (1)*, *(2)* and *(3)* are based on section 130(1) of CAA 1990. These give the conditions which must be met for the section to apply.

1336. *Subsection (4)* reduces the balancing allowance by increasing the proceeds of the sale by the sum of:

- any premium receivable for the grant of the subordinate interest; and
- the amount by which the open market value of the relevant interest, if sold with the subordinate interest in receipt of a commercial rent, exceeds the actual proceeds of the sale.

1337. *Subsection (5)* limits subsection (4) so as not to impose a balancing charge.

1338. *Subsection (6)* is based on section 130(5) of CAA 1990. It is a rule concerning the net proceeds of sale which is in addition to the rules set out in subsections (4) and (5). It only applies if, before the sale of the relevant interest, there is a variation in the terms of the grant of the subordinate interest. The result of that variation is:

- any capital payment for the variation is treated as if it were a premium for the grant of the subordinate interest; and
- whatever rent, if any, is payable under the subordinate interest is found by looking at the terms in force immediately before the sale.

1339. *Subsection (7)* is based on section 130(3) of CAA 1990. It means that the residue of qualifying expenditure immediately after the transfer is to be calculated as if the full balancing allowance before reduction by this section, had been made.

Section 390: Interpretation of section 389

1340. This section is based on section 130(4) of CAA 1990. It gives the meaning of various terms used here and in section 389.

Chapter 6: Supplementary provisions

Overview

1341. This Chapter gives effect to allowances and charges under Part 4. It also contains supplementary provisions.

1342. Section 391 sets out how allowances are to be given effect for a person who is carrying on a trade. Section 392 does the same thing for a person who does not have a trade but has a Schedule A business. And it gives a further rule for anyone who has neither a trade nor a Schedule A business.

1343. Section 393 provides for extended meanings of “freehold interest in land” and “lease” for the purposes of this Part of the Act. This is particularly important for the definitions of “the related agricultural land” in section 361 and “the relevant interest in relation to any qualifying expenditure” in section 364.

Section 391: Trades

1344. This section is based on section 132(1) of CAA 1990. It gives effect to agricultural buildings allowances for a person carrying on a trade by:

- treating the allowance as if it were an expense of the trade; and
- treating the charge as if it were a receipt of the trade.

Section 392: Schedule A businesses

1345. This section is based on section 132(2) of CAA 1990. It gives effect to agricultural buildings allowances for persons who are not carrying on a trade.

1346. *Subsection (2)* gives effect to allowances and charges for persons carrying on a Schedule A business. The allowances and charges are treated as if they were expenses and receipts of the business.

1347. *Subsection (3)* gives effect to allowances and charges for all other persons. They are treated as if they had a Schedule A business.

Section 393: Meaning of "freehold interest", "lease", etc.

1348. With regard to the meaning of "lease" this section is based on interpretative provisions found in sections 161(2) and 162 of CAA 1990.

Part 5: Mineral extraction allowances

Overview

1349. This Part provides for mineral extraction allowances. These can be writing-down allowances or balancing allowances. It also provides for balancing charges.

1350. Chapter 1:

- provides that allowances are available to mineral extraction traders who incur qualifying expenditure;
- defines "qualifying expenditure" and the other main terms that are used in Part 5; and
- signposts the detail on qualifying expenditure in the next four Chapters and sets out general exclusions from qualifying expenditure.

1351. Chapter 2 deals with qualifying expenditure on mineral exploration and access. It also deals with rules that apply if expenditure is incurred on mineral exploration and access before the mineral extraction trade starts.

1352. Chapter 3 deals with qualifying expenditure on acquiring a mineral asset. It contains special rules if an interest in land is involved. These prevent the non-mineral value of land from being qualifying expenditure. They also prevent double relief through capital allowances and the lease premium rules in section 87 of ICTA.

1353. Chapter 4 deals with second hand assets. It includes cases in which expenditure on acquiring a mineral asset is treated as if it was qualifying expenditure on mineral exploration and access. And it also includes cases in which qualifying expenditure is limited by reference to the circumstances of someone who previously sold the asset concerned.

1354. Chapter 5 deals with other sorts of qualifying expenditure. These relate to certain works, contributions and post-cessation restoration expenditure.

1355. Chapter 6 provides for the calculation of allowances and charges. Expenditure is not pooled. Allowances and disposal receipts reduce qualifying expenditure. Writing-down allowances are given at 10% a year on mineral asset expenditure or 25% on other expenditure on a reducing-balance basis. Disposal receipts may trigger balancing charges to recover allowances previously given. Balancing allowances are available when certain events occur.

1356. Chapter 7 provides for giving effect to allowances and charges and other matters.

History

1357. The Income Tax Act 1945 introduced mines, oil wells, etc. allowances (MOWA) for capital expenditure incurred by a person working a mine, oil well or other source of mineral deposits of a wasting nature. MOWA were limited to capital expenditure on mineral exploration and access or the construction of works likely to be of little value when the mineral source was no longer worked or a foreign concession came to an end. There was no relief for capital expenditure on acquiring the site of mineral deposits or the deposits themselves. In later years relief was extended to:

- overseas mineral rights (including land to the extent that its value was attributable to mineral deposits);
- abortive exploration connected with a mineral extraction trade;
- machinery and plant used for mineral exploration;
- certain land overseas;
- contributions to certain overseas buildings or works; and
- sources of mineral deposits in the UK.

1358. MOWA were output-related. No relief was given until a source of mineral deposits was worked or abandoned. This was out of line with other capital allowances.

1359. In contrast mineral extraction allowances, introduced, following consultation, by FA 1986, are similar to other capital allowances. But they are not identical to other allowances:

- annual allowances are a percentage of the balance of qualifying expenditure – known as the reducing-balance basis – like plant and machinery (and patents and know-how); but
- there is no pooling so – like industrial buildings and agricultural buildings – items of expenditure are dealt with separately.

1360. There were provisions in FA 1986 dealing with the transition from MOWA so that the MOWA provisions could be repealed instead of running on indefinitely. The main significance of these transitional provisions now is that they allow a recapture of excessive allowances to be made under this Part in respect of expenditure which originally qualified for MOWA. These provisions are dealt with in paragraph 88 of Schedule 3 (transitionals and savings).

1361. Since FA 1986 the main changes were in:

- FA 1996 which inserted section 118(2) of CAA 1990 dealing with purchases of an oil licence from a person who has not carried on a mineral extraction trade; and
- FA 1997 which inserted section 115(2A) of CAA 1990 dealing with purchases of mineral assets if the previous trader had incurred deductible expenditure on mineral exploration and access and that expenditure was reflected in the value of the purchased mineral asset.

Structure of this Part

1362. This Part:

- uses more Chapters for qualifying expenditure than are used in Part IV of CAA 1990 in order to make that material more accessible; and
- follows the same broad structure of other Parts.

Chapter 1: Introduction

Overview

1363. This Chapter introduces mineral extraction allowances. They are given on qualifying expenditure and are only available to mineral extraction traders.

1364. Section 394 sets out the basic conditions for entitlement to mineral extraction allowances and some definitions for this Part.

1365. Section 395 gives the meaning of qualifying expenditure and points to more detailed definitions and exceptions regarding qualifying expenditure.

1366. Sections 396 and 397 give the meaning of the key terms “mineral exploration and access” and “mineral asset”.

1367. Section 398 is a tie-breaker rule if expenditure might otherwise be on both mineral exploration and access and on a mineral asset.

1368. Section 399 sets out expenditure that cannot be qualifying expenditure.

Section 394: Mineral extraction allowances

1369. This section is based on section 98(1) and parts of sections 105(1), 109(1), 121(1) and (2) and section 161(2) of CAA 1990. It provides that allowances are available to mineral extraction traders who have incurred qualifying expenditure and defines “mineral extraction trade”. This term is used in place of the slightly longer term “trade of mineral extraction” in CAA 1990. The part of section 121(2) of CAA 1990 that is not rewritten in this section is at paragraph 87 of Schedule 3 because that part of section 121(2) relates only to that provision.

1370. *Subsection (3)* omits the examples of geothermal energy presently in section 161(2) of CAA 1990. They are not needed. See *Note 46* in Annex 2.

Section 395: Qualifying expenditure

1371. This section is based on part of section 105(1) and (3) of CAA 1990. It defines “qualifying expenditure” and indicates that there are two main classes of qualifying expenditure (on mineral exploration and access and on acquiring mineral assets).

1372. *Subsection (1)(c)* refers to amounts treated as qualifying expenditure on mineral exploration and access. In CAA 1990 these amounts are treated as expenditure on mineral exploration and access leaving to be inferred the fact that they are *qualifying* expenditure. See *Note 50* in Annex 2.

Sections 396 and 397: Meaning of “mineral exploration and access” and “mineral asset”

1373. These sections are based on section 121(1) and 105(6) of CAA 1990.

Section 398: Relationship between main types of qualifying expenditure

1374. This section is based on section 105(7) of CAA 1990.

Section 399: Expenditure excluded from being qualifying expenditure

1375. This section is based on section 105(4) and part of section 105(5) of CAA 1990. It sets out expenditure which does not qualify for allowances under this Part so as to give in this Chapter an early indication of items that will not get allowances under this Part. For example, most expenditure on plant or machinery cannot be qualifying expenditure.

Chapter 2: Qualifying expenditure on mineral exploration and access

Overview

1376. This Chapter defines what expenditure on mineral exploration and access is qualifying expenditure. The expenditure must be capital and it must be incurred for the purposes of the trade. This Chapter is subject to the rules in Chapter 4.

1377. Section 400 gives conditions for the expenditure to be qualifying expenditure. It has rules if the expenditure is connected with the trade and also if the expenditure is incurred before the trade starts.

1378. Section 401 gives rules for expenditure on mineral exploration and access incurred before the trade starts.

1379. Section 402 gives rules for expenditure on plant or machinery for mineral exploration and access if the plant or machinery is disposed of before the trade starts.

Section 400: Qualifying expenditure on mineral exploration and access

1380. This section is based on section 102 and parts of sections 98(1), 105, 106, 107 and 120(2) of CAA 1990. It gives the conditions for expenditure on mineral exploration and access to be qualifying expenditure.

1381. There is a minor change. *Subsection (1)* requires that qualifying expenditure must be capital expenditure incurred for the purposes of the mineral extraction trade. The purpose test in subsection (1)(b) is not in section 105(1) of CAA 1990. But this does not affect allowances. This is because allowances are only available under section 98(1) of CAA 1990 if the purpose test is met. See *Change 47* in Annex 1.

1382. *Subsection (2)* treats expenditure incurred on mineral exploration and access in connection with a mineral extraction trade as being incurred for the purposes of the mineral extraction trade. This could, for instance, allow capital expenditure incurred on mineral exploration and access to be qualifying expenditure if the start of a mineral extraction trade depended on the mineral exploration and access being successful. In such a case the expenditure is connected with the new trade but it might be difficult to say that all of the expenditure was incurred for the purposes of the trade.

1383. The rest of the section deals with limitations on subsection (1) if "pre-trading expenditure" on mineral exploration and access is involved. Section 395 signposts limitations in other Chapters.

1384. *Subsection (4)* avoids some duplication that exists in CAA 1990 as to the time at which the qualifying expenditure is treated as incurred. See *Note 51* in Annex 2.

Section 401: Pre-trading exploration expenditure

1385. This section is based on section 107 of CAA 1990. It deals with mineral exploration and access expenditure, other than on plant or machinery, incurred before a person starts a mineral extraction trade.

1386. The section limits the qualifying expenditure if there are relevant receipts before the trade starts. It also limits qualifying expenditure if mineral exploration and access ceases at the source concerned before the trade starts.

Section 402: Pre-trading expenditure on plant or machinery

1387. This section is based on section 106 and part of section 156 of CAA 1990. It provides the only instance in which expenditure on plant or machinery can be qualifying expenditure under this Part. Such plant or machinery must have been sold, demolished, destroyed or abandoned before the person starts a mineral extraction trade. Where the plant or machinery is still owned when the trade starts relief is given under Part 2. See section 161.

1388. The section limits the qualifying expenditure if there are any receipts from the sale, demolition, destruction or abandonment of the plant or machinery before the trade starts. It also limits qualifying expenditure if mineral exploration and access ceases at the source concerned before the trade starts.

1389. There is a minor change. *Subsection (5)(c)* provides for a "relevant receipt" in relation to the abandonment of certain plant or machinery. Section 156 of CAA 1990 does not give an amount in respect of the abandonment of plant or machinery. This follows the change made in relation to section 61(2) and provides for the "relevant receipt" in such a case to be the insurance money or other compensation received. See *Change 10* in Annex 1.

Chapter 3: Qualifying expenditure on acquiring a mineral asset

Overview

1390. This Chapter defines when expenditure on acquiring a mineral asset is qualifying expenditure. The expenditure must be capital expenditure and it must be for the purposes of the trade. This Chapter is subject to the rules in Chapter 4.

1391. Section 403 gives conditions for the expenditure to be qualifying expenditure. It points to exceptions and defines a term for use in this Chapter.

1392. Section 404 prevents the value of land from being qualifying expenditure so far as it is not attributable to the value of mineral deposits.

1393. Section 405 permits, in limited circumstances, some or all of the value excluded from qualifying expenditure under the previous section to become qualifying expenditure.

1394. Section 406 prevents expenditure from getting relief twice under both the lease premium rules in section 87 of ICTA and as a result of this Chapter.

Section 403: Qualifying expenditure on acquiring a mineral asset

1395. This section is based on parts of sections 98(1) and 105(1) and (3) of CAA 1990. It gives the conditions for expenditure on acquiring a mineral asset to be qualifying expenditure. It must be capital expenditure and incurred for the purposes of the mineral extraction trade.

1396. There is a minor change in subsection (1)(b) as in section 400(1)(b). See paragraph 1381 above and *Change 47* in Annex 1.

1397. *Subsection (2)* signposts two limitations on subsection (1) later in this Chapter. Section 395 signposts limitations in other Chapters.

Section 404: Exclusion of undeveloped market value of land

1398. This section is based on part of section 110 of CAA 1990. It prevents the underlying value of land from being qualifying expenditure.

Example

Assume this section applies to the purchase by B of an interest in land for £1,000. The land would be worth £200 if there were no mineral deposits in the land.

Subsection (1) stops £200 from being qualifying expenditure.

The remaining £800 might be qualifying expenditure but other provisions in this and the next Chapter might mean that the qualifying expenditure is less than £800.

1399. *Subsection (1)* omits the reference in section 110(1) of CAA 1990 to the land including a source of mineral deposits as that follows from the requirement that the interest in the land is a mineral asset.

1400. *Subsection (5)(b)* contains a test by reference to general development orders in England; section 110(3)(b) of CAA 1990 refers to Wales as well. This change has no practical effect at present. See *Change 48* in Annex 1.

1401. *Subsection (7)* deals with something that is not explicit in CAA 1990. If A transfers a mineral asset to B and they successfully elect to treat B as acquiring the mineral asset on a "step-in-shoes basis" from A then this section does not require B to reduce that "step-in-shoes basis".

Section 405: Qualifying expenditure where buildings or structures cease to be used

1402. This section is based on part of section 110 of CAA 1990. It applies if a part of the undeveloped market value of land is attributable to buildings or structures that permanently cease to be used. If the conditions in the section are satisfied some or all of that part of the undeveloped market value is treated as qualifying expenditure.

Example

Assume that in the example in paragraph 1398 above:

£50 of the £200 (that the land would be worth without the mineral deposits) is attributable to a building on the land;

B gets no capital allowances in relation to that building; and

the building becomes permanently disused by reason of B demolishing it.

This section allows the £50 to be qualifying expenditure.

Section 406: Reduction where premium relief previously allowed

1403. This section is based on section 111 of CAA 1990. It reduces acquisition expenditure to the extent that relief on it has already been obtained under the lease premium rules in section 87 of ICTA. This prevents double relief for the same expenditure.

Chapter 4: Qualifying expenditure: second-hand assets

Overview

1404. This Chapter treats, in certain cases, expenditure on a mineral asset as if it were expenditure on mineral exploration and access. The rate at which allowances are given for qualifying expenditure on mineral exploration and access is higher than for qualifying expenditure on a mineral asset. In certain cases the Chapter also limits, by reference to the position of previous owners of the asset, qualifying expenditure on acquiring an asset.

1405. Section 407 treats part of the cost of a mineral asset as qualifying expenditure on mineral exploration and access if part of the value of the mineral asset is attributable to expenditure of "the previous trader" on mineral exploration and access.

1406. Section 408 reduces, in certain cases, the cost of an interest in an oil licence acquired from someone who was not a mineral extraction trader. Some of the reduction may be treated as qualifying expenditure on mineral exploration and access.

1407. Section 409 limits qualifying expenditure on an asset if it represents expenditure on mineral exploration and access incurred by a seller who was not a mineral extraction trader.

1408. Section 410 limits qualifying expenditure if the mineral asset is an interest in a UK oil licence.

1409. Section 411 limits qualifying expenditure if a "previous trader" has owned the asset concerned. The limit is to the previous traders unrelieved residue of expenditure.

1410. Section 412 and section 413 prevent "groups" from increasing the capital expenditure on a mineral asset by means of intra-group transfers.

Section 407: Acquisition of mineral asset owned by previous trader

1411. This section is based on section 115 and parts of sections 113 and 114 of CAA 1990. There is a minor change in subsection (1)(a) as in sections 400 and 403 (paragraphs 1381 and 13961396 above). See *Change 47* in Annex 1.

1412. *Subsection (5)(a)* treats part of the trader's expenditure on acquiring the mineral asset as qualifying expenditure on mineral exploration and access in those cases if this section applies.

1413. *Subsection (5)(b)* makes a corresponding reduction to the trader's expenditure on acquiring the mineral asset.

Example

Assume that:

(a) mineral extraction trader B acquires for £1,000 a mineral asset that used to be owned by a previous trader P; and

(b) P had incurred £50 capital expenditure on mineral exploration and access and this capital expenditure is reflected as to £100 (of B's purchase price) in the value of the mineral asset.

£50 is the lower of the two amounts in (b). B is treated as incurring:

(i) £50 of qualifying expenditure on mineral exploration and access; and

(ii) only £950 on the purchase of the mineral asset – but it may not all be qualifying expenditure because other restrictions in Chapter 3 or 4 may apply.

1414. There is nothing in this section for section 115(2)(b) of CAA 1990 which is unnecessary. See *Note 52* in Annex 2.

Section 408: Acquisition of oil licence from non-trader

1415. This section is based on section 118(2) and sections 118(1) and 138A of CAA 1990. It sets out the proposition in section 118(2) after the necessary adaptations required by section 138A.

1416. *Subsection (1)* applies this section if:

- the trader acquires an interest in an oil licence the value of which is partly attributable to mineral exploration and access expenditure of the seller; and
- the seller has not carried on a mineral extraction trade.

1417. There is a minor change in subsection (1)(a) as in sections 400, 403 and 407 (paragraphs 1381, 1396 and 1412 above). See *Change 47* in Annex 1.

1418. *Subsection (2)(b)* reduces the trader's expenditure on acquiring the mineral asset by "E2".

1419. *Subsection (2)(a)* treats the trader as incurring qualifying expenditure on mineral exploration and access of an amount that is capped at "E2".

Example

Assume that:

mineral extraction trader, B, acquires an oil licence for £1,000 from S;

S is not a mineral extraction trader, but S has incurred expenditure of £50 on mineral exploration and access; and

it is just and reasonable to attribute £300 of B's purchase price to the £50 spent by S.

B is treated as incurring:

£50 of qualifying expenditure on mineral exploration and access; and

only £700 (£1,000 - £300) on the purchase of the oil licence – but it may not all be qualifying expenditure because other restrictions in Chapter 3 or 4 may apply.

Section 409: Acquisition of other assets from non-traders

1420. This section is based on sections 118(1) and 121(3) of CAA 1990. If the seller of an asset has not been a mineral extraction trader it caps the buyer's qualifying expenditure on acquiring an asset, if that asset represents the seller's expenditure on mineral exploration and access. The cap is the amount of the seller's mineral exploration and access expenditure represented by that asset.

1421. There is a minor change in *subsection (1)(a)* as in sections 400, 403, 407 and 408 (paragraphs 1381, 1396, 1412 and 1417 above). See *Change 47* in Annex 1.

Section 410: UK oil licence: limit is original licence payment

1422. This section is based on section 116 of CAA 1990. It caps the qualifying expenditure on acquiring an interest in a UK oil licence to the amount originally paid to obtain the oil licence (or a reasonable part of the original payment).

1423. *Subsection (4)* makes it explicit that the cap does not affect any part of the expenditure that is treated as qualifying expenditure on mineral exploration and access by the first two sections in this Chapter.

Section 411: Assets generally: limit is residue of previous trader's qualifying expenditure

1424. This section is based on sections 113 and 114 of CAA 1990. It prevents an increase in qualifying expenditure if the trader acquires an asset that, broadly, has previously been owned by another mineral extraction trader for the purposes of that earlier owner's mineral extraction trade. The qualifying expenditure on acquiring the asset is limited to the residue of the previous trader's qualifying expenditure.

Example

Assume that:

mineral extraction trader, B, buys a mineral asset for £1,000;

the mineral asset was previously owned by a previous trader, P; and

P's residue of qualifying expenditure related to the asset is £500.

B's qualifying expenditure cannot exceed £500.

1425. *Subsection (8)* makes it explicit that the cap does not affect any part of the expenditure that is treated as qualifying expenditure on mineral exploration and access by the first two sections in this Chapter.

Section 412: Transfers of mineral assets within group: limit is initial group expenditure

1426. This section is based on part of section 117 of CAA 1990. It prevents an increase of qualifying expenditure on a mineral asset through a transfer between companies under common control.

1427. This is done by limiting the acquiring company's capital expenditure on acquiring the mineral asset to the selling company's capital expenditure on acquiring that mineral asset. This restriction is wider, in one sense, than the restriction in section 411 because this restriction applies even if a previous trader has not owned the mineral asset. Both restrictions can apply to the same acquisition.

Example

Assume that parent company A sells a mineral asset (originally bought for £500) to its subsidiary B for its then market value of £1000.

This section limits B's capital expenditure to £500 – but it may not all be qualifying expenditure because other restrictions in Chapter 3 or 4 may apply.

1428. Subsection (2), in referring to "just and reasonable apportionment", is a minor change. See *Change 40* in Annex 1.

1429. *Subsection (5)* modifies the application of section 404 so that, broadly, the undeveloped market value of land is computed at the time the group first acquired the mineral asset. This is because the group's capital expenditure is effectively limited to the capital expenditure that the group incurred (ignoring group transfers) on acquiring the mineral asset.

1430. *Subsections (6)* and *(7)* make corresponding modifications of section 405 if subsection (5) has applied. They put the buyer in broadly the same position as if the buyer had owned the interest in land from the time that it was purchased by the first group company.

Section 413: Transfers of mineral assets within group: supplementary

1431. This section is based on part of section 117 of CAA 1990.

1432. *Subsection (2)(b)* makes explicit that section 412 does not apply if an election is made for "step-in-shoes" treatment to apply to the buying company in relation to the mineral asset. That treatment will reflect an earlier deduction for the undeveloped market value of land.

1433. *Subsection (4)* makes it explicit that the cap in the previous section does not affect any part of the expenditure that is treated as qualifying expenditure on mineral exploration and access by the first two sections in this Chapter.

Chapter 5: Other kinds of qualifying expenditure

Overview

1434. This Chapter deals with qualifying expenditure that is neither on mineral exploration and access nor on acquiring a mineral asset.

1435. Section 414 permits expenditure on works to be qualifying expenditure if the works would have no value if:

- there were no mineral deposits; or
- the mineral deposits could not be worked.

1436. Section 415 permits certain contributions, to works for the benefit of employees abroad, to be qualifying expenditure.

1437. Section 416 permits certain post cessation restoration expenditure to be treated as qualifying expenditure that was incurred on the last day of trading.

Section 414: Expenditure on works likely to become valueless

1438. This section is based on parts of sections 98(1), 105 and 161(2) of CAA 1990. Capital expenditure on the construction of certain works may be qualifying expenditure if the works would have little or no value if the source could not be worked.

1439. There is a minor change in*subsection (1)(b)* as in sections 400, 403, 407, 408 and 409. See *Change 47* in Annex 1.

Section 415: Contribution to buildings or works for benefit of employees abroad

1440. This section is based on section 108 of CAA 1990. It provides that capital sums contributed to the cost of certain buildings or works, to be used essentially for the benefit of persons employed abroad, may be qualifying expenditure if connected with the working of a source outside the UK and the other conditions in the section are satisfied.

1441. There is a minor change *in subsection (1)(a)* as in sections 400, 403, 407, 408, 409 and 414 (paragraphs 1381, 1396, 1412, 1417, 1421 and 1439 above). See *Change 47* in Annex 1.

Section 416: Expenditure on restoration within 3 years of ceasing to trade

1442. This section is based on section 109 of CAA 1990. It allows certain restoration expenditure to be qualifying expenditure provided it is incurred within three years of the mineral extraction trade ceasing. The expenditure must meet the condition that it would have been either qualifying expenditure or deductible as a trading expense if it had been incurred before the trade ceased.

1443. Allowances are only available in Part IV of CAA 1990 on qualifying expenditure that meets the purposes of the mineral extraction trade test in section 98(1) of CAA 1990. That purpose test is not reproduced in this section. This is a change that is favourable to the taxpayer. See *Change 47* in Annex 1.

Chapter 6: Allowances and charges

Overview

1444. This Chapter deals with allowances and charges on qualifying expenditure. There is no pooling of qualifying expenditure. Allowances may be balancing allowances or writing-down allowances. Writing-down allowances are given on a reducing-balance basis at rates of 10% on mineral asset expenditure and 25% in other cases. Disposal

receipts may arise in respect of qualifying expenditure on the happening of certain events. Disposal receipts either restrict the allowances on that qualifying expenditure or result in balancing charges to recover excessive allowances. Balancing allowances are available on different kinds of qualifying expenditure in different circumstances.

1445. Section 417 sets out whether an allowance is available or a charge will be made for a chargeable period.

1446. Section 418 quantifies the allowance or charge.

1447. Section 419 defines the term "UQE" used in the previous two sections.

1448. Section 420 defines the term "disposal receipt" used in the earlier sections in terms of a "disposal value" to be brought into account.

1449. Section 421 and section 422 provide for the circumstances in which, and the chargeable period for which, a disposal value is to be brought into account in relation to qualifying expenditure.

1450. Section 423 and section 424 deal with the amount of a disposal value to be brought into account.

1451. Section 425 deals with an additional case, the receipt of a capital sum, in which a disposal value is brought into account in relation to qualifying expenditure.

1452. Sections 426 to 431 set out the periods in which a balancing allowance is available in relation to different kinds of qualifying expenditure.

Section 417: Determination of entitlement or liability

1453. This section is based on section 98(2) and (3) and section 100(1) of CAA 1990. It determines whether, in respect of qualifying expenditure, there is entitlement to an allowance or liability to a charge in a chargeable period. It is similar to section 55 in Part 2.

1454. There is no equivalent of sections 53 and 54 because qualifying expenditure is not pooled in this Part. The main factor common to the calculation of allowances in Part 2 is that writing-down allowances in this Part are also computed by applying a percentage to an amount which reduces from one chargeable period to the next – known as the reducing-balance basis.

1455. The meaning of "UQE" and "TDR" and when balancing allowances may be due are dealt with in detail later in the Chapter.

Section 418: Amount of allowances and charges

1456. This section is based on section 98(4) to (6) and section 100(2) and (3) of CAA 1990. It is similar to section 56. It determines the amount of entitlement or charge.

1457. *Subsection (4)* caps balancing charge(s) in respect of qualifying expenditure at the amount of allowances actually given on that qualifying expenditure. This can be expressed more directly than in Part 2 because pooling is not involved in calculating allowances and charges in this Part.

1458. *Subsection (6)* permits a person to claim less than the full amount of the allowance. See *Change 38* in Annex 1.

Section 419: Unrelieved qualifying expenditure

1459. This section is based on section 98(2) and (3) of CAA 1990.

Section 420: Meaning of "disposal receipt"

1460. This section provides a signpost to the provisions in this Part and elsewhere that deal with this term. "Disposal receipts" are the amount of disposal value that the mineral extraction trader is required to bring into account and they feed into the three earlier sections dealing with entitlement/liability, amount and "UQE" respectively.

Section 421: Disposal of, or ceasing to use, asset

1461. This section is based on section 99(1) of CAA 1990. It requires a disposal value to be brought into account on an asset being disposed of or permanently ceasing to be used for the purposes of the mineral extraction trade.

Section 422: Use of asset otherwise than for permitted development etc.

1462. This section is based on section 99(1) and (2) and section 110(3) of CAA 1990. It requires a disposal value to be brought into account if certain developments occur. This can happen without the mineral asset being disposed of or permanently ceasing to be used for the purposes of the mineral extraction trade.

1463. There is a minor change. *Subsection (4)(b)* contains a test by reference to general development orders in England. Section 110(3)(b) of CAA 1990 refers to Wales as well. This change has no practical effect at present. See *Change 48* in Annex 1.

Section 423: Sections 421 and 422: amount of disposal value to be brought into account

1464. This section is based on section 99(3) and section 26(1) of CAA 1990. It gives the amount of the disposal value to be brought into account if one of the previous two sections applies.

1465. CAA 1990 leaves readers to adapt section 26 of that Act for the purposes of section 99(1) of that Act. It is clear that not all of section 26 is relevant to section 99(1) but it could be time consuming to arrive at the necessary adaptations.

1466. This section contains a Table setting out the disposal value so that reference to provisions in Part 2 and adaptations are not required in this Act.

1467. Item 2 of the Table is based on section 99(3) of CAA 1990. It refers to the disposal value as market value at the time of sale. See *Note 17* in Annex 2.

Section 424: Disposal value restricted in case of interest in land

1468. This section is based on sections 99(3), 110 and 112 of CAA 1990. It excludes the undeveloped market value of land in arriving at its disposal value. This is because the undeveloped market value of land is excluded from qualifying expenditure when an interest in land is acquired.

1469. There is a minor change. *Subsection (5)(b)* contains a test by reference to general development orders in England whereas section 110(3)(b) of CAA 1990 refers to Wales as well. This change has no practical effect at present. See *Change 48* in Annex 1.

Section 425: Receipt of capital sum

1470. This section is based on section 99(4) of CAA 1990. It requires capital sums, reasonably attributable to qualifying expenditure, to be brought into account as disposal values.

1471. *Subsection (3)* stops a capital sum from being taken into account twice.

Section 426: Pre-trading expenditure

1472. This section is based on section 101(5) of CAA 1990. It sets out the qualifying expenditure concerned and the chargeable period in which any allowance in respect of it will be a balancing allowance.

1473. The qualifying expenditure is pre-trading expenditure on mineral exploration and access if, before the trade began, the mineral exploration and access permanently ceased at the source concerned. The chargeable period is the one in which the trade begins.

Sections 427 to 431

1474. These sections are based on sections 99(1), 101 and 161(2) of CAA 1990. They provide other circumstances in which a person is entitled to a balancing allowance for the qualifying expenditure concerned.

Chapter 7: Supplementary provisions

Overview

1475. This Chapter deals with giving effect to allowances and charges and other matters.

1476. Section 432 sets out how allowances and charges are given effect for the mineral extraction trade.

1477. Section 433 gives relief for demolition costs in certain cases.

1478. Section 434 deals with when expenditure actually incurred before the trade starts is to be treated as incurred in this Part.

1479. Section 435 treats this Part as applying to shares in assets as it applies to parts of assets.

1480. Section 436 defines some terms used in this Part.

Section 432: Giving effect to allowances and charges

1481. This section is based on sections 104, 140(2), 144(2) and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges as trading expenses or receipts for the chargeable period concerned.

Section 433: Treatment of demolition costs

1482. This section is based on sections 103 and 161(2) of CAA 1990. It allows net demolition costs to be added to the qualifying expenditure concerned in calculating the balancing allowance or balancing charge arising on the demolition of an asset representing qualifying expenditure.

1483. *Subsection (3)* stops the cost of demolition from being relieved more than once.

Section 434: Time when expenditure incurred

1484. This section is based on section 120(1) of CAA 1990.

1485. *Subsection (2)* avoids duplication that exists in CAA 1990 as to the time at which the qualifying expenditure is treated as incurred. See *Note 51* in Annex 2.

Section 435: Share in assets

1486. This section is based on section 121(5) of CAA 1990.

Section 436: Meaning of "development" etc.

1487. This section is based on section 121(1) of CAA 1990.

Part 6: Research and development allowances

Overview

1488. This Part provides for research and development (R&D) allowances. Unlike other Parts the allowances are not labelled as initial, first-year, writing-down or balancing allowances. Allowances are broadly given at a rate of 100%. Balancing charges can recover "excessive allowances".

1489. The aim is to give traders relief against trading income for capital expenditure on R&D. The R&D must be related to the trade and directly undertaken by the trader or on his or her behalf.

1490. Chapter 1 is introductory. It requires a person to have incurred qualifying expenditure on R&D to get allowances. The Chapter gives the meaning of "research and development" and what may be treated as expenditure on R&D.

1491. Chapter 2 gives the meaning of "qualifying expenditure". Only traders can have qualifying expenditure and such expenditure must be incurred on R&D which is directly undertaken by the trader or on behalf of the trader. The cost attributable to bare land or most dwellings is not qualifying expenditure.

1492. Chapter 3 deals with allowances and charges on qualifying expenditure. There is no pooling of qualifying expenditure. The rate of allowances is 100%. Allowances are broadly given for the chargeable period in which occurs the later of:

- the trade starting; or
- the qualifying expenditure being incurred.

1493. When the trader ceases to own an asset representing qualifying expenditure a disposal value is brought into account (usually for the chargeable period in which it ceases to be owned). Disposal values either restrict allowances on the qualifying expenditure or lead to a balancing charge. Demolition costs may reduce disposal values or qualify for an allowance.

1494. Chapter 4 treats certain additional VAT liabilities as expenditure on R&D and certain additional VAT rebates as disposal values. The consequences of such treatment follow from the earlier Chapters. The additional VAT must be incurred or made by the time the asset in question is destroyed or ceases to be owned.

1495. Chapter 5 contains supplementary provisions including the treatment of allowances as trading expenses and charges as trading receipts.

History

1496. This Part has its origins in sections 28, 29 and 31 of FA 1944 (when the allowances were known as "scientific research allowances"). Minor changes were made to those sections in Income Tax Act 1945 (the Act which introduced capital allowances generally for expenditure on, among other things, industrial buildings and machinery or plant).

1497. Allowances were originally given for R&D expenditure (then called "scientific research expenditure") of a capital nature over five years at 20% a year.

1498. If the expenditure was represented by an asset, there could be no claim for other types of capital allowance while the asset continued in use for R&D related to the trade concerned. But, if that asset ceased to be so used, there was then a balancing adjustment. The adjustment ensured the net relief equalled any loss in value of the asset by the date of its change of use. After that adjustment the person could claim other types of capital allowance.

1499. Section 20 of FA 1949 changed the rate of R&D allowances to 60% in the first year and 10% in each of the next four years.

1500. Section 21 of FA 1954 introduced provisions giving accelerated relief for the cost of demolishing assets representing capital expenditure on R&D.

1501. Section 36 of FA 1963:

- increased R&D allowances to 100%;
- amended the provisions dealing with "balancing allowances" and "balancing charges" to fit the new regime of 100% allowances; and
- provided that if an asset was bought and sold in the same year, an allowance was given in that year on any net cost of the asset. As a result any allowance otherwise due in the next year (on the preceding year basis of assessment then in force) was not to be given.

1502. Section 63 of FA 1985 stopped R&D allowances being given:

- on the cost of acquiring land or rights in or over land (except to the extent that part of the cost is properly attributable to a current building or structure on that land); and
- for expenditure on the provision of residential accommodation (except if the accommodation forms part of the premises used for R&D and the cost of that accommodation is not more than 25% of the cost of the entire structure).

1503. FA 1985 also expanded the recapture of allowances on an asset ceasing to be owned – previously a sale of the asset was required.

1504. Section 62 of FA 1988 introduced new capital gains tax and capital allowance rules for arm's length disposals, made at the "pre-development" stage, of interests in oil licences in the UK or on the UK Continental Shelf. The new rules applied if the consideration for the disposal included either:

- an obligation to undertake a program of exploration and appraisal work in the area covered by the licence; or
- another such "pre-development" licence interest.

1505. Such consideration is treated as having a nil value for the purpose of recovering R&D allowances on the disposal of the licence interest.

1506. Section 121 and Schedule 13 of FA 1989 introduced provisions that:

- allow apportionment of expenditure if an asset is sometimes to be used for R&D and sometimes to be used for other purposes;
- define when an asset, that is sold, ceases to be owned; and
- give a single set of provisions to prevent double allowances whereby claimants make an irrevocable choice as to what type of allowance they wanted on particular expenditure.

1507. CAA 1990 consolidated the provisions about capital allowances (other than those contained in Chapter I of Part XIII of ICTA).

1508. FA 1991 introduced changes so that:

- additional VAT liabilities on an amount that got a R&D allowance might also qualify for such an allowance; and
- additional VAT rebates would give rise to a recapture of allowances.

1509. FA 1996 inserted section 138A of CAA 1990. This was to make sure that R&D allowances on capital expenditure on mineral exploration and access could be recovered on the disposal of an interest in an oil licence, to the extent that the expenditure had added value to the oil licence. This provision applied retrospectively as well as prospectively. FA 1996 therefore inserted section 138B of CAA 1990 to cater for the potentially retrospective element of section 138A. Section 138B allowed the transferor to use a lower disposal value than that given by section 138A, if that value was also used in calculating the transferee's entitlement to capital allowances.

1510. FA 1996 also:

- applied section 151 of CAA 1990, dealing with apportionments that could affect more than one person, to Part VII of CAA 1990; and
- extended the relief mentioned in paragraph 1504 above so that it applies to oil licences world-wide and not only to UK and UK Continental Shelf licences.

1511. FA 2000 changed:

- the term "scientific research" previously used to the present term "research and development";
- introduced a more detailed definition of what constitutes R&D; and
- ensured that appeals on the meaning of "research and development" could go to an independent tribunal.

Chapter 1: Introduction

Overview

1512. This Chapter introduces R&D allowances. They are given to traders who incur qualifying expenditure. Chapter 2 defines "qualifying expenditure" and contains the condition that the person must be a trader.

1513. Section 437 requires qualifying expenditure on R&D in order for allowances to be given and defines "research and development".

1514. Section 438 gives the meaning of "expenditure on research and development". That meaning excludes, with minor exceptions, expenditure on dwellings.

Section 437: Research and development allowances

1515. This section is based on section 139(1)(a) of CAA 1990.

1516. *Subsection (1)* provides that qualifying expenditure on R&D is needed before allowances can be made.

1517. *Subsection (2)* gives the extended meaning of "research and development" in this Part to include oil and gas exploration and appraisal.

Section 438: Expenditure on research and development

1518. This section is based on sections 137(3) and 139(1)(c) of CAA 1990. It sets out what is included and excluded from being expenditure on R&D and also permits just and reasonable apportionments of expenditure.

1519. *Subsection (4)* is more explicit than section 137(3) of CAA 1990, in that it only permits certain expenditure on a dwelling to be treated as on R&D. See *Note 53* in Annex 2.

1520. *Subsection (5)* requires any apportionment to be "just and reasonable". This is a change, see *Change 40* in Annex 1.

Chapter 2: Qualifying expenditure

Overview

1521. This Chapter defines "qualifying expenditure" and excludes expenditure on "land" from being qualifying expenditure.

1522. Section 439 defines "qualifying expenditure".

1523. Section 440 prevents expenditure on land from being qualifying expenditure subject to exceptions for existing buildings or structures on the land.

Section 439: Qualifying expenditure

1524. This section is based on sections 137(1) and (4) and 139(1)(d) and (2) of CAA 1990.

1525. It sets out the conditions to be satisfied for a person to have qualifying expenditure. There are two threads depending on whether the expenditure is incurred while the person is trading or before that trade starts.

1526. Some conditions are common to the two threads. These are that:

- the person must be a trader;
- the expenditure must be capital expenditure incurred by the person on R&D; and
- the R&D must be directly undertaken by the person or on the person's behalf.

1527. For expenditure incurred before the person starts trading, the trade has to be connected with the R&D.

1528. For expenditure incurred while trading, the trade must be related to the R&D.

1529. *Subsection (3)* introduces "the relevant trade" as a term that can be used to avoid the need for phrases such as "the trade in respect of which the expenditure has been treated as qualifying expenditure".

1530. *Subsection (4)* requires any apportionment to be "just and reasonable". This is a change, see *Change 40* in Annex 1.

1531. *Subsection (5)* extends the R&D that can be treated as related to a trade that the person is carrying on.

Section 440: Excluded expenditure: land

1532. This section is based on section 137(2) of CAA 1990. It stops the cost of land (other than the amount attributable to buildings or structures on the land) from being qualifying expenditure.

1533. Section 137(2) of CAA 1990 takes a slightly different approach. It prevents allowances being given on such expenditure but it is not thought that there is any difference. For a more detailed discussion see *Note 54* in Annex 2.

1534. *Subsection (3)* uses the term "just and reasonable apportionment". This is a change, see *Change 40* in Annex 1.

Chapter 3: Allowances and charges

Overview

1535. This Chapter deals with allowances and charges on qualifying expenditure. There is no pooling of qualifying expenditure. An allowance can be made in respect of qualifying expenditure only for one chargeable period. Disposal values may arise in relation to qualifying expenditure on the happening of certain events. Disposal values restrict

allowances on the qualifying expenditure or result in balancing charges to recover excessive allowances. Demolition costs may reduce balancing charges or, in certain cases, give rise to allowances.

1536. Section 441 sets out when an allowance can be made, the chargeable period for which it is made and its amount.

1537. Section 442 sets out when a person is liable to a balancing charge and its amount.

1538. Section 443 deals with disposal values and the events on which they arise. Disposal values are relevant to the previous two sections. There are signposts to a special provision relating to oil licences and also to the Chapter dealing with additional VAT rebates.

1539. Section 444 deals with the chargeable period for which a disposal value is to be brought into account.

1540. Section 445 sets out relief available for the costs of demolishing an asset representing qualifying expenditure.

Section 441: Allowances

1541. This section is based on sections 137(1) and (5) and 138(2) of CAA 1990.

1542. This section uses the term "allowances" instead of "deduction in taxing a trade" which is found in CAA 1990. See *Note 55* in Annex 2 for more detail.

1543. CAA 1990 essentially gives an allowance of 100% of qualifying expenditure and a charge (capped at the allowance given) of all of the disposal value relating to that qualifying expenditure. This section takes a different approach.

1544. *Subsection (1)* gives an allowance in the relevant chargeable period. The allowance equals the excess of qualifying expenditure over any disposal value taken into account for that relevant chargeable period (instead of an allowance equal to that qualifying expenditure and a charge on that disposal value). See *Change 39* in Annex 1.

1545. *Subsection (2)* defines "relevant chargeable period", a term used in subsection (1). There are minor differences between the formulation used in subsection (2)(b) and that used in section 137(5) of CAA 1990 which looks at whether the expenditure was incurred "before the setting up and commencement of the trade" rather than before the chargeable period in which the trade is set up and commenced. See *Note 56* in Annex 2.

1546. *Subsection (3)* permits a claim of less than the full amount of an allowance to be made by the person. See *Change 38* in Annex 1.

Section 442: Balancing charges

1547. This section is based on section 138(1), (2) and (2A) of CAA 1990.

1548. *Subsections (1)* to *(3)* provide a balancing charge if a disposal value arises in a chargeable period after the one in which an allowance is made in respect of the qualifying expenditure concerned. There is no longer a balancing charge in the same period as an allowance is made – see *Change 39* in Annex 1. The balancing charge is limited to the allowance previously made in respect of that qualifying expenditure. Section 138(2) of CAA 1990 refers to a "trading receipt" but it seems clearer to follow the other Parts of this Act and refer to a balancing charge. It is not thought that this has any effect. See *Note 55* of Annex 2.

1549. *Subsection (4)* defines the term "unclaimed allowance". Most people will claim all of the allowances to which they are entitled because there is no possibility of getting any amount unclaimed in a later chargeable period. But having recognised the possibility that a reduced claim may be made it is necessary to ensure that balancing charges are

not made if such a person has a disposal value but the allowance claimed is not more than the net cost of the R&D asset concerned. This is achieved by subsection (3)(a) which uses this term. See *Change 49* in Annex 1.

1550. *Subsection (5)* signposts the effect that additional VAT rebates may have on the amount in subsection (4). That alerts users who may be affected but leaves this section simple for the majority who will not be affected by VAT rebates.

Section 443: Disposal values and disposal events

1551. This section is based on sections 138(1), (3A), (4), (5) and (6) and 138A(1) of CAA 1990. It says when a disposal value is brought into account and gives a Table from which the amount of the disposal value can be found.

1552. *Subsection (1)* gives the main cases in which a disposal value must be brought into account.

1553. *Subsection (2)* is a signpost to another case in which a disposal value must be brought into account.

1554. *Subsection (3)* gives cases excluded from subsection (1).

1555. *Subsection (4)* has a Table giving the disposal value if subsection (1) applies. There are minor changes referring to:

- "net proceeds" of sale; section 138(4)(a) of CAA 1990 refers to "proceeds"; and
- limiting other compensation to "capital sums" – a limitation which is not in section 138(5) of CAA 1990

1556. These bring the Table closer to the formulations used in other Parts of this Act. See *Change 50* in Annex 1.

1557. *Subsection (5)* sets out exceptions from subsection (4).

1558. *Subsection (6)* provides a signpost to a provision concerning additional VAT rebates that could lead to a disposal value being brought into account without the existence of a disposal event.

1559. *Subsection (7)* defines "disposal event".

Section 444: Disposal events: chargeable period for which disposal value is to be brought into account

1560. This section is based on section 138(2) of CAA 1990.

1561. *Subsection (1)* says that this section is about the chargeable period for which a disposal value under section 443 is brought into account. Section 138(2) of CAA 1990 gives a specific time at which, essentially, a balancing charge arises whereas this section provides a chargeable period for which a disposal value arises. The approach in this section is more consistent with other Parts of this Act that bring disposal values into account for a chargeable period and with R&D allowances being given for a chargeable period. See *Note 57* in Annex 2.

1562. *Subsections (2)* and *(3)* deal with the normal case in which the disposal event occurs after the chargeable period for which an allowance is made. They also deal with the less usual case in which the disposal event occurs in the same chargeable period as an allowance is made for the qualifying expenditure. Subsection (3)(a) contains a change. See *Change 51* in Annex 1.

1563. *Subsection (4)* deals with the unusual case in which a disposal event occurs before the chargeable period for which an allowance is due in respect of the qualifying expenditure concerned. CAA 1990 does not appear to explicitly address this situation. Section

138(3) of CAA 1990 looks as if it might be in point but it does not handle this case satisfactorily. Subsection (4) deals with the unusual case in a more coherent fashion. See *Change 51* in Annex 1.

Section 445: Costs of demolition

1564. This section is based on sections 138(5) and 139(5) of CAA 1990. Section 138(5) is particularly difficult to follow. Its reference to "the person carrying on the trade" might suggest that demolition costs are ignored if they are incurred before the trade commences. This section proceeds on the basis that such costs ought not to be ignored. See *Change 52* in Annex 1.

1565. *Subsections (1)* to *(3)* allow the net demolition costs of an asset representing qualifying expenditure to reduce the disposal value that arises on that demolition.

1566. *Subsections (4)* and *(5)* provide for an allowance if the net demolition costs are greater than the disposal value. But only if, prior to demolition, the asset has only ever been used for R&D related to the relevant trade.

1567. *Subsection (6)* stops the demolition costs being taken into account more than once.

Chapter 4: Additional VAT liabilities and rebates

Overview

1568. This Chapter deals with the effect of additional VAT liabilities and rebates in respect of an asset representing qualifying expenditure. They can result in additional qualifying expenditure or generate (or increase) a disposal value.

1569. Section 446 points to the definition of the terms used in this Chapter.

1570. Section 447 treats certain additional VAT liabilities as if they were capital expenditure on R&D.

1571. Section 448 treats certain additional VAT rebates as if they were disposal values and deals with their effect on the calculation of allowances and charges in later chargeable periods.

Section 446: Introduction

1572. This section gives a signpost to the places where the terms used in this Chapter are defined. Those definitions apply to several Parts.

Section 447: Additional VAT liability treated as additional expenditure etc.

1573. This section is based on sections 137(1A), 138(1) and 159A(3) of CAA 1990.

1574. *Subsection (1)* treats the additional VAT liability as if it was capital expenditure on the same R&D. That is a necessary, but not sufficient, condition for the additional VAT liability to be qualifying expenditure.

1575. *Subsection (2)* excludes from subsection (1) additional VAT liabilities incurred after a certain time.

1576. *Subsection (3)* gives the chargeable period for which an allowance resulting from an additional VAT liability is to be made. The wording of subsection (3)(b) is related to section 441(2)(b). See *Note 56* in Annex 2.

Section 448: Additional VAT rebate generates disposal value

1577. This section is based on section 138(3A) of CAA 1990. It treats an additional VAT rebate, to which the section applies, as if it is a disposal value to be brought into account

(usually) for the chargeable period in which the rebate accrues. The words "or, if the rebate is made on or after the date on which the trade is permanently discontinued, accruing immediately before the discontinuance" at the end of section 138(3A) are thought to be unnecessary and have not been rewritten. See *Note 58* in Annex 2.

1578. *Subsections (1)* to *(3)* set out the additional VAT rebates to which the section applies. The reference in section 138(3A) of CAA 1990 to a person "carrying on a trade" could be thought to indicate that VAT rebates are ignored if they are made before the relevant trade starts. Section 444 now provides that relief can be obtained for the commercial loss where an asset is bought and sold at a loss before the relevant trade starts. It would be odd if VAT rebates made in relation to such an asset, and which are a factor in arriving at the commercial loss, were ignored. This section proceeds on the basis that such rebates are taken into account just as an additional VAT liability incurred before the relevant trade starts might be taken into account under section 137(1A) and 137(5) of CAA 1990. See *Change 53* in Annex 1.

1579. *Subsections (4)* and *(5)* provide that the VAT rebate is treated as a disposal value. This differs from section 138(3A) of CAA 1990 that effectively provides that the whole of the VAT rebate is treated as a balancing charge. In most cases this will have no effect because the person has claimed a 100% allowance. But it could have an effect if the person claims less than the full allowance available on the qualifying expenditure. This change reduces the charge in such a case. See *Change 49* in Annex 1.

Section 449: Effect on balancing charges of additional VAT rebates in earlier chargeable periods

1580. This section is based on section 138(1), (2) and (2A) of CAA 1990.

1581. The treatment of VAT rebates as disposal values under section 448 means that, in contrast to section 138(3A) of CAA 1990, the receipt of the VAT rebate may not lead to a balancing charge because there are unclaimed allowances under section 442(4).

1582. To the extent that an unclaimed allowance shields a disposal value in one chargeable period this section reduces, for later chargeable periods, that unclaimed allowance by the amount shielded so that relief is not obtained more than once. See *Change 49* in Annex 1.

Chapter 5: Supplementary provisions

1583. This Chapter deals with giving effect to allowances and charges and the time when an asset that is sold ceases to be owned.

Section 450: Giving effect to allowances and charges

1584. This section is based on sections 137(1), 140(2) and (5), 144(2) and (3) and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges as trading expenses or trading receipts in the chargeable period for which they are made.

Section 451: Sales: time of cessation of ownership

1585. This section is based on section 139(4) of CAA 1990. It defines references to the time of cessation of ownership in the case of a sale.

Part 7: Know-how allowances

Overview

1586. This Part provides for know-how allowances. The allowances are available to traders who incur qualifying expenditure on acquiring know-how for use in their trade. There is a defined class of know-how in relation to which qualifying expenditure can

arise. Qualifying expenditure is pooled for the purpose of calculating entitlement to allowances and liability to charges.

1587. Chapter 1 requires a person to have incurred qualifying expenditure on acquiring know-how to get allowances. It also:

- defines "know-how" for the purposes of this Part; and
- treats know-how as property so that general provisions of this Act which refer to property can apply to know-how.

1588. Chapter 2 defines "qualifying expenditure" for a trader and sets out cases in which there is no qualifying expenditure. The same expenditure can only be qualifying expenditure in relation to one trade – so that relief is only given once.

1589. Chapter 3 deals with entitlement to allowances or liability to charges and the amounts involved. Qualifying expenditure is pooled to calculate allowances and charges. There is a separate pool for each trade for which there is qualifying expenditure. Disposal values can arise in relation to qualifying expenditure. Disposal values come out of the pool and thus effectively reduce allowances or result in balancing charges. There is no limit on disposal values in this Part. This Chapter also gives effect to allowances and charges. They are treated as trading expenses or receipts.

History

1590. Section 21 of FA 1968 introduced provisions giving traders capital allowances for capital expenditure on acquiring know-how. The allowances were given, broadly, on a straight line basis over six years. A balancing allowance was available if the trade permanently ceased before the end of the six-year period. There were also provisions dealing with receipts from the disposal of know-how. Section 21 was treated as if it was contained in Part I of CAA 1968. This legislation was consolidated as sections 386 and 387 of ICTA 1970 but still treated as if it was in Part I of CAA 1968.

1591. Section 65 of, and Schedule 18 to, FA 1985 altered the system of capital allowances for know-how so that expenditure is pooled. Allowances are no longer given on the separate items of expenditure but on the reducing balance in the pool. The earlier system of giving balancing allowances in relation to individual items of expenditure was also replaced by a system for balancing adjustments closer to, but not identical to, that for plant and machinery.

1592. The provisions in ICTA 1970 and Schedule 18 to FA 1985 were consolidated as sections 530, 531, 532 and 533 of ICTA. Sections 530, 531, 532 and 533 were treated as if they were in Part I of CAA 1968. Subsequently they were treated as if they were in CAA 1990.

Structure of this Part

1593. As nearly 15 years have passed since 1 April 1986 the previous system for giving capital allowances over six years does not need to be rewritten. Section 530(6) and (8) of ICTA is therefore not rewritten in this Act.

1594. This Part:

- brings the legislation dealing with capital allowances (broadly section 530 and parts of sections 531 to 533 of ICTA) into this Act in order to make it more accessible; and
- splits that material into separate Chapters having regard to both the structure of know-how allowances and the structure used for other allowances.

1595. Section 531 of ICTA deals with more than just capital allowances. Section 531(1) is relevant to trading income and section 531(4) is relevant for income taxed under Case

VI of Schedule D. The parts of section 531 that are not about capital allowances remain in ICTA.

Chapter 1: Introduction

Overview

1596. This Chapter introduces know-how allowances. They are given to traders who incur qualifying expenditure. Chapter 2 defines "qualifying expenditure" and contains the condition that the person must be a trader. This Chapter defines "know-how" and treats it as property.

1597. Section 452 requires qualifying expenditure on acquiring know-how in order for allowances to be given and defines "know-how".

1598. Section 453 treats know-how as property.

Section 452: Know-how allowances

1599. This section is based on sections 532(1) and 533(7) of ICTA and section 161(2) of CAA 1990. It explains that allowances are only available to persons who incur qualifying expenditure on acquiring know-how. The section defines "know-how".

1600. *Subsection (3)(a)* omits the examples of geothermal energy in section 161(2) of CAA 1990. They are not needed. See *Note 46* in Annex 2.

Section 453: Know-how as property

1601. This section is based on section 532(5)(a) of ICTA. It treats know-how as property for this Act. This allows general provisions of this Act to apply to know-how. There would otherwise have to be specific provisions saying that this or that section applies to know-how as it does to property with the necessary modifications. An example of these general provisions is the provision dealing with apportionment of consideration on sales of property.

Chapter 2: Qualifying expenditure

Overview

1602. This Chapter defines "qualifying expenditure" and excludes certain expenditure from being qualifying expenditure.

1603. Section 454 defines "qualifying expenditure", stops a person taking it into account for more than one trade and deals with expenditure incurred before the trade starts.

1604. Section 455 stops certain expenditure being qualifying expenditure if:

- it is relieved in some other way;
- treated as on goodwill; or
- arises from a transaction between certain persons and there is common control.

Section 454: Qualifying expenditure

1605. This section is based on section 530(1) and (7) and section 531(3) of ICTA. It defines "qualifying expenditure".

1606. *Subsection (1)* lists the expenditure on acquiring know-how that is qualifying expenditure. A person must carry on a trade in order to have qualifying expenditure but that expenditure may be incurred before the trade starts.

1607. *Subsection (2)* stops capital allowances being given more than once on the same qualifying expenditure. This provision does not appear explicitly in ICTA. See *Note 59* in Annex 2.

1608. *Subsection (3)* ensures that qualifying expenditure qualifies for allowances when the relevant trade starts in the case of qualifying expenditure incurred before that trade starts.

1609. *Subsection (4)* defines a term used in subsection (3).

Section 455: Excluded expenditure

1610. This section is based on sections 530(1) and 531(2) and (7) of ICTA. It deals with those cases in which expenditure on know-how is not qualifying expenditure.

1611. *Subsection (1)* excludes expenditure that has been deducted in some other fashion – for example under section 531(5) of ICTA.

1612. *Subsections (2)* and *(3)* exclude expenditure if the buyer and seller are under common control.

1613. *Subsection (4)* excludes expenditure that section 531(2) of ICTA treats as expenditure on goodwill for all the purposes of corporation tax, income tax and capital gains tax.

Chapter 3: Allowances and charges

Overview

1614. This Chapter deals with allowances and charges on qualifying expenditure. Qualifying expenditure is pooled. There is a separate pool for each trade. Disposal values can arise in relation to qualifying expenditure. Disposal values effectively reduce allowances or lead to balancing charges.

1615. Section 456 requires pooling of qualifying expenditure to be carried out separately for each trade concerned.

1616. Section 457 sets out whether there is an allowance or a charge for a chargeable period.

1617. Section 458 deals with the amount of the allowance or charge.

1618. Sections 459 to 461 set out how to find "AQE" which is a term used in the earlier sections.

1619. Section 462 deals with when a disposal value is to be brought into account, and its amount, in respect of qualifying expenditure.

1620. Section 463 gives effect to allowances and charges as trading expenses or trading receipts.

Section 456: Pooling of expenditure

1621. This section is drafted to introduce pooling explicitly.

1622. *Subsection (2)* provides explicitly that there is a separate pool in respect of each trade for which there is some qualifying expenditure. It can be inferred from section 530(2)(b) of ICTA that there are separate pools for separate trades.

Section 457: Determination of entitlement or liability

1623. This section is based on section 530(2) and (3) of ICTA. It decides if a person is entitled to an allowance or liable to a charge.

1624. Section 459 defines "AQE" in the pool for a chargeable period. Section 462 decides if a disposal value is brought into account for a chargeable period (and how much).

Section 458: Amount of allowances and charges

1625. This section is based on section 530(2) and (3) of ICTA. *Subsections (1)* to *(3)* set out the calculation of a writing-down allowance for a chargeable period. The rate at which writing-down allowances are given is 25% per year. The amount of a writing-down allowance is adjusted if the chargeable period is more or less than a year and if the trade is carried on for only part of the chargeable period.

1626. There is a minor change.*Subsection (4)* allows a person to claim a writing-down allowance of less than the full entitlement for the chargeable period. See *Change 38* in Annex 1.

1627. *Subsections (5)* and *(6)* set out the calculation of a balancing charge or balancing allowance for a chargeable period.

Section 459: Available qualifying expenditure

1628. This section is based on section 530(4) of ICTA. It defines "available qualifying expenditure" in a pool for a chargeable period. That is essentially any unrelieved qualifying expenditure brought forward from the previous chargeable period plus any qualifying expenditure added to the pool for the current chargeable period.

Section 460: Allocation of qualifying expenditure to pools

1629. This section is based on section 530(4)(a) of ICTA. It sets out when qualifying expenditure can be added to a pool.

1630. There is a minor change. This section allows qualifying expenditure to be added to a pool either in the chargeable period in which it is incurred or in a later chargeable period. This is in line with the approach taken in this Act to plant and machinery allowances in Part 2. It gives taxpayers flexibility – albeit it is only likely to be of practical interest in unusual circumstances. See *Change 54* in Annex 1.

Section 461: Unrelieved qualifying expenditure

1631. This section is based on section 530(4)(b) of ICTA. It sets out the amount that is carried forward in a pool from one chargeable period to the next chargeable period.

1632. *Subsection (3)* stops any amount being carried forward after the trade is permanently discontinued. This makes explicit the fact that the pool ceases to exist on the ending of the trade in relation to which that pool exists. There would only be unrelieved qualifying expenditure if the taxpayer were to choose, for some reason, not to claim all of a balancing allowance that is available on the trade cessation. See *Note 60* in Annex 2.

Section 462: Disposal values

1633. This section is based on sections 530(5) and 531(2) of ICTA. It determines disposal values and the periods for which they are to be brought into account.

1634. *Subsection (2)* gives the amount brought into account. It limits the amounts to capital sums, which makes explicit the fact that receipts that are income do not come out of the pool in addition to being taxed as income. ICTA does not limit the disposal value to capital sums. See *Change 55* in Annex 1.

Section 463: Giving effect to allowances and charges

1635. This section is based on section 532(1) of ICTA and sections 140(2), 144(2) and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges as trading expenses or

receipts. This makes explicit the way in which effect is given to allowances and charges. See *Note 61* in Annex 2.

Part 8: Patent allowances

Overview

1636. This Part provides for patent allowances. The allowances are available to persons who incur qualifying expenditure on patent rights for the purposes of a trade or who are taxable on any income receivable from those patent rights. Qualifying expenditure is pooled for the purpose of calculating entitlement to allowances and liability to charges.

1637. Chapter 1 introduces the Part. It requires a person to have incurred qualifying expenditure on purchasing patent rights to get allowances. It defines "patent rights" and provides for the application of the Part to:

- rights to acquire future patent rights; and
- the grant and acquisition of licences.

1638. Chapter 2 defines "qualifying expenditure" for the purposes of patent allowances. This may be qualifying trade expenditure or qualifying non-trade expenditure.

1639. Chapter 3 deals with determining entitlement to allowances or liability to charges and calculating the amounts involved. Qualifying expenditure is pooled. There is a separate pool for each trade for which there is qualifying trade expenditure and one pool for qualifying non-trade expenditure. Disposal receipts can arise in relation to qualifying expenditure. Disposal receipts come out of the pool and effectively reduce entitlement to allowances or result in balancing charges. The disposal receipt (or total disposal receipts if there are part disposals of the patent rights) in relation to an item of qualifying expenditure is limited to that qualifying expenditure.

1640. Chapter 4 contains the rules about how allowances and charges are given effect for the chargeable period:

- allowances and charges for qualifying trade expenditure are treated as trading expenses or receipts of the trade; and
- allowances for qualifying non-trade expenditure are deducted from patent income and there are provisions for carry forward of excess allowances. Charges for qualifying non-trade expenditure are treated as Case VI income for income tax and as patent income for corporation tax.

1641. Chapter 5 contains supplementary provisions. These include a rule limiting qualifying expenditure in cases of purchases between connected parties or for avoidance.

1642. Provisions for expenditure incurred before 1 April 1986 are in paragraphs 92 to 102 of Schedule 3.

History

1643. Income Tax Act 1945 introduced capital allowances for patent rights. It also introduced provisions dealing with the "revenue treatment" of capital profits from the sale of patent rights.

1644. Allowances were originally given for each separate item of capital expenditure on the purchase of patent rights. Those allowances were given on a straight line basis over, broadly, the life of the patent rights that had been bought. A balancing allowance was available on the disposal of the whole of the patent rights if the sale proceeds were less than the unrelieved cost of the patent rights at the time of the sale. Balancing charges were made if patent rights were sold for more than the unrelieved cost of the patent rights at the time of the sale.

1645. FA 1986 changed the way allowances are given. Capital expenditure on the purchase of patent rights incurred after 31 March 1986 is pooled. Allowances are given on the balance in the pool. There are also balancing allowances and charges similar to, but not identical with, those for plant and machinery.

1646. Both sets of provisions – for expenditure before and after the changes in 1986 – were consolidated in Chapter I of Part XIII of ICTA together with provisions about the "revenue treatment" of capital profits. These are sections 520 to 529 and 532 and 533 of ICTA.

Structure of this Part

1647. This Part:

- brings the legislation dealing with capital allowances (broadly all or parts of sections 520 to 523, 528, 532 and 533 of ICTA) into this Act in order to make it more accessible; and
- splits that material into separate Chapters having regard to both the structure of patent allowances and the structure used for other allowances.

Chapter 1: Introduction

Overview

1648. This Chapter introduces patent allowances. They are given to persons incurring qualifying expenditure on the purchase of patent rights. The Chapter defines "patent rights". It contains extensions to deal with licences and cases if a patent has not yet been granted for an invention. "Qualifying expenditure" is defined in Chapter 2.

1649. Section 464 requires qualifying expenditure on purchasing patent rights in order for allowances to be given and defines "patent rights".

1650. Section 465 extends this Part to deal with certain cases concerning rights in respect of an invention if a patent has not yet been granted.

1651. Section 466 extends this Part to deal with grants of licences in respect of patents.

Section 464: Patent allowances

1652. This section is based on section 533(1) of ICTA. It explains that allowances under this Part are only available to persons who incur qualifying expenditure on purchasing patent rights and defines "patent rights".

Section 465: Future patent rights

1653. This section is based on section 533(5) and (6) of ICTA. It treats expenditure by a person on the right to acquire future patent rights as if it was on the purchase of patent rights – even if a patent has not yet been granted in respect of the invention. Relief would not be available to the payer without this provision.

1654. *Subsection (2)* treats the expenditure on the right to acquire future patent rights as if it were expenditure on the patent rights if that person subsequently acquires those rights.

1655. *Subsection (4)* gives corresponding treatment to the recipient of the payment. It treats the recipient as receiving the sum for a sale of patent rights even if a patent has not yet been granted for the invention.

Section 466: Grant of licences

1656. This section is based on section 533(2) and (3) of ICTA. It enables:

- section 468 or 469 to apply to licence acquisitions. They would not otherwise as they require a *purchase* of patent rights; and
- section 476(2) to apply to the grant of a licence. Section 476(2) requires a *sale* of patent rights.

Chapter 2: Qualifying expenditure

Overview

1657. This Chapter defines "qualifying expenditure". There are two types of qualifying expenditure. The way in which allowances are given in respect of the two types is different.

1658. Section 467 sets out the two types of qualifying expenditure.

1659. Section 468 deals with qualifying trade expenditure.

1660. Section 469 deals with non-trade qualifying expenditure.

Section 467: Qualifying expenditure

1661. This section introduces the two types of qualifying expenditure. The main difference between them is in the way allowances and charges are given effect in Chapter 4.

Section 468: Qualifying trade expenditure

1662. This section is based on sections 520(1), (2)(a) and (3), 528(1) and 532(1) of ICTA and section 161(3) of CAA 1990. It defines "qualifying trade expenditure".

1663. *Subsection (1)* incorporates the effect of section 161(3) of CAA 1990. See *Note 74* in Annex 2.

1664. *Subsection (2)* prevents capital allowances being given more than once on the same qualifying expenditure. This is to make the point explicit. See *Note 59* in Annex 2.

1665. *Subsection (3)* treats qualifying expenditure incurred before the trade starts as if it was incurred when the trade starts.

1666. *Subsection (4)* prevents subsection (3) applying if a person sells all of the patent rights before the trade starts.

Section 469: Qualifying non-trade expenditure

1667. This section is based on section 520(2)(b) of ICTA. It defines "qualifying non-trade expenditure".

Chapter 3: Allowances and charges

Overview

1668. This Chapter deals with allowances and charges on qualifying expenditure. Qualifying expenditure is pooled. There is a separate pool for each trade for which a person has qualifying trade expenditure and a single pool for a person's qualifying non-trade expenditure. Disposal receipts can arise in relation to qualifying expenditure. Disposal receipts effectively reduce allowances or lead to balancing charges.

1669. Section 470 requires pooling and sets out the separate pools.

1670. Section 471 sets out whether there is an allowance or a charge for a chargeable period.

1671. Section 472 deals with the amount of the allowance or charge.

1672. Sections 473 to 475 set out how to find "AQE" which is a term used in the earlier sections.

1673. Section 476 and 477 deal with when a disposal receipt is to be brought into account in respect of qualifying expenditure and its amount.

Section 470: Pooling of expenditure

1674. This section is drafted to introduce pooling explicitly.

1675. *Subsection (2)* provides that there is a separate pool for each trade for which a person has qualifying trade expenditure and a single pool for any qualifying non-trade expenditure of that person. As with plant and machinery and know-how, this Act refers explicitly to these separate pools rather than, as in CAA 1990, leaving them to be deduced.

Section 471: Determination of entitlement or liability

1676. This section is based on section 520(4) to (6) of ICTA. It determines if a person is entitled to an allowance of liable to a charge. It applies to each pool separately for each chargeable period.

1677. Section 473 defines "AQE" in the pool for a chargeable period. Section 476 defines the "disposal receipts" which contribute to the calculation of TDR to come out of the pool for a chargeable period.

1678. There is a minor change. *Subsections (4)* to *(6)* determine if an entitlement to an allowance is to a writing-down allowance or a balancing allowance. In the case of qualifying non-trade expenditure, subsection (6) provides for a balancing allowance when all of the patent rights, on which such expenditure was incurred, have been wholly disposed of or come to an end. Section 520(4)(c) and (5) of ICTA might be read as denying a balancing allowance if the last of the relevant patent rights does not come to an end but is wholly disposed of. See *Change 56* in Annex 1.

Section 472: Amount of allowances and charges

1679. This section is based on section 520(4) and (6) of ICTA. It determines the amount of a writing-down allowance.

1680. *Subsections (1)* to *(3)* set out the calculation of a writing-down allowance for a chargeable period. The rate at which writing-down allowances are given is 25% per year on a reducing-balance basis. The amount of a writing-down allowance is adjusted if the length of the chargeable period is more or less than a year and if the trade was carried on for only part of the chargeable period.

1681. There is a minor change. *Subsection (4)* allows a person to claim a writing-down allowance of less than the full entitlement for the chargeable period. There is nothing for this in CAA 1990. See *Change 38* in Annex 1.

1682. *Subsections (5)* and *(6)* set out the calculation of a balancing charge or allowance for a chargeable period.

Section 473: Available qualifying expenditure

1683. This section is based on section 521(1) of ICTA. It defines "available qualifying expenditure" in a pool for a chargeable period.

Section 474: Allocation of qualifying expenditure to pools

1684. This section is based on sections 520(2), 521(1)(a) and 528(1) of ICTA. It allows qualifying expenditure to be put into the pool either in the chargeable period in which it is incurred or in a later chargeable period.

1685. There is a minor change. This section allows qualifying expenditure to be allocated to a pool for any chargeable period subject to the specific provisions in subsections (2) to (4). So it allows qualifying expenditure to be added to a pool for a chargeable period after that in which it is incurred. It is unlikely that taxpayers will in practice wish to do so. But this flexibility is consistent with the approach taken for plant and machinery allowances in Part 2. See *Change 54* in Annex 1.

Section 475: Unrelieved qualifying expenditure

1686. This section is based on section 521(1)(b) of ICTA. It sets out the amount that is carried forward in a pool from one chargeable period to the next chargeable period.

1687. *Subsection (3)* stops any amount being carried forward after the trade is permanently discontinued. There would only be unrelieved qualifying expenditure if the taxpayer were to choose for some reason not to claim all of a balancing allowance that is available in those circumstances. See *Note 60* in Annex 2.

Section 476: Disposal value of patent rights

1688. This section is based on section 521(2) of ICTA. It defines "disposal receipt". It is the disposal value under this section or (in rare circumstances) under Schedule 12 to FA 1997 or any other enactment.

1689. *Subsection (2)* sets out when disposal values are to be brought into account.

1690. *Subsection (3)* sets out the amount of a disposal value under this section. But this is subject to section 477. That ensures the disposal values in relation to particular patent rights do not exceed the qualifying expenditure incurred on the purchase of those patent rights.

1691. There is a minor change. This section limits the amounts to capital sums. This makes clear that proceeds that are income are not *both* taxed as income and brought into account as disposal receipts. ICTA does not limit the disposal value to capital sums. See *Change 55* in Annex 1.

Section 477: Limit on amount of disposal value

1692. This section is based on section 521(3) and (4) of ICTA. It limits a person's disposal value, or disposal values, from a sale of patent rights to the qualifying expenditure incurred by that person on purchasing the rights.

1693. *Subsections (2)* and *(3)* increase the limit of a person's disposal value, or disposal values, if the patent rights were acquired from a connected person.

Chapter 4: Giving effect to allowances and charges

Overview

1694. This Chapter deals with the way in which allowances and charges are made. They are treated as trading expenses and receipts if qualifying trade expenditure is involved. They are treated as deductions from patent income or, broadly, as patent income if qualifying non-trade expenditure is involved.

1695. Section 478 deals with allowances and charges for a pool of qualifying trade expenditure.

1696. Section 479 deals, for income tax, with allowances and charges for a pool of qualifying non-trade expenditure.

1697. Section 480 deals, for corporation tax, with allowances and charges for a pool of qualifying non-trade expenditure.

Section 478: Persons having qualifying trade expenditure

1698. This section is based on sections 528(1) and 532(1) of ICTA and sections 140(2), 144(2), and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges in respect of qualifying trade expenditure as trading expenses or receipts. This treatment is what one would expect but the path to it in CAA 1990 is not straightforward. See *Note 61* in Annex 2.

Section 479: Persons having qualifying non-trade expenditure: income tax

1699. This section is based on sections 528(2) and (4) of ICTA. It gives effect to allowances and charges for non-trade qualifying expenditure for income tax.

1700. It does not reproduce the words at the end of section 528(2)(b) of ICTA about tax being discharged or repaid accordingly. Nor does it reproduce the closing words of section 528(2) which require a claim for relief to be made under that subsection. See *Note 63* in Annex 2.

1701. The second half of section 532(1) of ICTA is not rewritten. See *Note 62* in Annex 2.

1702. *Subsection (4)* treats charges in respect of qualifying non-trade expenditure as income taxable under Case VI of Schedule D. Such charges are treated as income from patents by section 483, which allows the charges to be reduced by allowances in respect of qualifying non-trade expenditure.

Section 480: Persons having qualifying non-trade expenditure: corporation tax

1703. This section is based on sections 528(3) and (4) of ICTA. It gives effect to allowances and charges for non-trade qualifying expenditure for corporation tax.

1704. *Subsection (3)* provides that excess allowances can be carried forward and deducted from patent income of later accounting periods so long as the company remains within the charge to tax. The second half of section 532(1) of ICTA does not allow a more generous offset of such excess allowances. See *Note 62* in Annex 2.

1705. *Subsection (4)* treats charges in respect of qualifying non-trade expenditure as income from patents. This treatment allows charges to be reduced by allowances in respect of qualifying non-trade expenditure.

Chapter 5: Supplementary provisions

Overview

1706. This Chapter deals with limits on qualifying expenditure in certain cases and minor provisions that do not naturally fit into earlier Chapters.

1707. Section 481 deals with limits on qualifying expenditure if:

- the purchase of patent rights is from a connected person; or
- a main benefit is to get patent allowances.

1708. Section 482 deals with certain payments by a government if the payments may not be under a licence of patent rights.

1709. Section 483 defines “patent income”.

Section 481: Anti-avoidance: limit on qualifying expenditure

1710. This section is based on section 521(5) and (6) of ICTA. It puts limits on the amount of qualifying expenditure if a person purchases patent rights from a connected person or as part of a transaction that has as a main benefit the obtaining of allowances.

Section 482: Sums paid for Crown use etc. treated as paid under licence

1711. This section is based on section 533(4) of ICTA. It treats certain sums paid by a government in relation to a patented invention as if the payments were made under a licence. This allows the sections in this Part referring to sales of patent rights to operate on such payments.

Section 483: Meaning of "income from patents"

1712. This section is based on section 533(1). It defines "income from patents". That term is used in sections 479 and 480 to describe the amount against which allowances in respect of qualifying non-trade expenditure can be offset.

Part 9: Dredging allowances

Overview

1713. This Part is based on Part VI of CAA 1990. It provides for dredging allowances. These are writing-down allowances or, for the chargeable period in which the qualifying trade is discontinued or sold, a balancing allowance. Entitlement to, and the amount of, dredging allowances depend on qualifying expenditure.

1714. The rules for allowances made for previous chargeable periods in section 134(3) of CAA 1990 are in paragraph 104 of Schedule 3.

1715. The rules for contributions to dredging expenditure in section 134(8) of CAA 1990 are contained in sections 533 and 543.

Background

1716. Dredging allowances are only available for capital expenditure on dredging. Dredging does not include normal maintenance work on an existing channel. Much of the expenditure on dredging by harbour boards (for example) will be revenue expenditure and will have no capital element. Industrial Buildings Allowances (IBA) are available for the construction of docks and canals in suitable trades, see Part 3 and section 274 (in which docks and inland navigation undertakings are listed as qualifying trades). So dredging allowances can supplement the IBA relief. Similarly the equipment used for dredging will normally qualify for plant and machinery allowances. And routine dredging to keep a waterway open will be allowable as a revenue expense under Case I of Schedule D. The dredging allowances code supplements these other reliefs by providing relief for expenditure which would otherwise not enjoy tax relief.

1717. The code also provides for expenditure paid to a third party carrying on a dredging trade to qualify for relief. A typical situation would be if an industrial trader pays a harbour board a fee to improve, by way of dredging, access to industrial facilities.

History

1718. The 1952 Royal Commission on the Taxation of Profits and Income recommended that allowances should be available for the capital cost of cutting or tunnelling land.

1719. In response to this recommendation FA 1956 extended allowances for industrial buildings in respect of expenditure on preparing, cutting, tunnelling or levelling land for the purpose of constructing an industrial building or structure, and introduced a new system of allowances for capital expenditure on dredging.

1720. When the legislation relating to capital allowances was consolidated in CAA 1990 the provisions on dredging became Part VI of that Act (sections 134 and 135).

1721. Under FA 1956, allowances for dredging were given at the same rates as allowances for industrial buildings. There was an initial allowance of 10% and an annual writing-

down allowance of 2%. The writing-down period was 50 years. Dredging allowances differed from industrial buildings allowance in that there were no balancing charges or balancing allowances. There was an additional allowance, equivalent to a balancing allowance, if the relevant trade was permanently discontinued.

1722. The 2% rate and the 50-year period are still relevant for expenditure incurred before 5 November 1962. The legislation for this is in paragraphs 103 and 105 of Schedule 3 to this Act.

1723. FA 1963 increased the annual rate of writing-down allowances for both industrial buildings and dredging from 2% to 4% for expenditure incurred after 5 November 1962. As part of a wider reform of business taxation, FA 1985 abolished initial allowances, including those for dredging.

1724. Paragraph 105 of Schedule 3 deals with the writing-down period if allowances were made under paragraph 27(2) of Schedule 14 to FA 1965.

Section 484: Dredging allowances

1725. This section provides for dredging allowances for qualifying trades.

1726. *Subsection (1)* sets out the general rule. Dredging allowances are available if a person carries on a qualifying trade and incurs expenditure on dredging.

1727. *Subsection (2)* defines "qualifying trade". This is either a trade like a dock or harbour authority or a qualifying trade for the purposes of industrial buildings allowances in Part 3.

1728. *Subsection (3)* provides that dredging does not include anything done otherwise than in the interests of navigation.

1729. *Subsection (4)* expands the natural meaning of "dredging" to include such things as river and canal widening as well as the removal of things projecting from the bed of a waterway even if they are above the surface.

Section 485: Qualifying expenditure

1730. This section is based on sections 134(1), (6) and 135(1) of CAA 1990. It deals with "qualifying expenditure", a term which is not itself in CAA 1990. Its use here gives this Part likeness with the rest of the Act.

1731. *Subsection (1)* sets out the basic condition for qualifying expenditure.

1732. *Subsection (2)* deals with expenditure partly incurred for the purposes of the trade and partly for other purposes and provides a just and reasonable apportionment. Use of "just and reasonable apportionment" in place of "just apportionment" is a minor change. See *Change 40* in Annex 1.

1733. *Subsection (3)* deals with the situation if only part of a trade qualifies.

Section 486: Pre-trading expenditure of qualifying trades, etc.

1734. This section is based on sections 134(7) and 135(2) of CAA 1990. It deals with pre-trading expenditure.

1735. *Subsection (1)* deals with pre-trading expenditure and deems it to be incurred on the first day that the trade is carried on.

1736. *Subsection (2)* deals with expenditure if the premises in connection with which the expenditure was incurred are not yet occupied for the purposes of the trade. This could be if the expenditure is in connection with an existing trade but could also be if the expenditure is incurred before the trade is carried on. The expenditure is treated as incurred when the premises are occupied for the purposes of the trade.

1737. If expenditure is incurred before both:

- the trade has begun; and
- the premises are occupied,

then the expenditure is treated as incurred when both the premises are occupied and the trade carried on. See *Change 57* in Annex 1.

Section 487: *Writing-down allowances*

1738. This section is based on section 134(1) of CAA 1990. It deals with writing-down allowances. Unlike CAA 1990 this Act makes explicit how writing-down allowances work.

1739. *Subsections (1)* and *(2)* deal with the writing-down period (25 years) and the consequent amount of allowance (4% a year).

1740. If expenditure was incurred before 6 November 1962 then the writing-down allowance is 2% and the period 50 years. See paragraphs 103 and 105 of Schedule 3.

1741. *Subsections (4)* and *(5)* deal with chargeable periods longer or shorter than a year and confirm that total allowances cannot exceed expenditure.

1742. *Subsection (6)* makes it explicit that the allowance can be reduced to a specified amount. This is a change. See *Change 38* in Annex 1.

1743. *Subsection (7)* prevents a writing-down allowance in the same chargeable period as a balancing allowance. CAA 1990 allows a writing-down allowance for the chargeable period of a balancing allowance but this simply means that the amount of the balancing allowance is reduced by the amount of the writing-down allowance in that chargeable period. So this is not a change. See *Note 64* in Annex 2.

Section 488: *Balancing allowances*

1744. This section is based on section 134(2) and (4) of CAA 1990. It deals with balancing allowances and the events that lead to them.

1745. *Subsection (1)* sets out the rules for determining whether there is a balancing allowance in any chargeable period.

1746. *Subsection (1)(b)* sets out the two disposal events for this Part: discontinuance and sale. Section 134(4) of CAA 1990 deals with a sale by deeming it to be a discontinuance. This Act deals with it as a separate circumstance that can lead to a balancing allowance.

1747. As a result this section does not need the reference in section 134(4) of CAA 1990 to section 343(2) of ICTA. There is no longer anything that might look as if it overrides section 343(2) (which provides that, on a company reconstruction in certain circumstances, a trade is not deemed to have been discontinued). See *Note 64* in Annex 2.

1748. *Subsection (2)* deals with the amount of the balancing allowance. The allowance is the unrelieved expenditure. This differs from the approach in other Parts. In those, disposal proceeds are normally taken into account in working out the amount of a balancing adjustment. Doing so brings the net allowances into line with the actual depreciation of an asset. But with dredging there is generally no identifiable asset as a result of the expenditure. There is nothing to which one can point in order to apportion to it proceeds from the sale of a trade. And it would be difficult to put a value on the worth of the dredging. For these reasons this Part gives a balancing allowance equal to the whole of the expenditure. Balancing allowances are also subject to some anti-avoidance rules – see subsections (4), (5) and (6).

1749. *Subsection (3)* gives rules about permanent discontinuance. The discontinuance rules in sections 113(1) and 337(1) of ICTA do not apply. This means that a change in the persons carrying on a trade will not trigger a disposal event (and a balancing allowance) in this Part.

1750. *Subsection (4)* prevents the sale of a trade from being a disposal event if the sale is of a type described in either subsection (5) or (6).

1751. *Subsection (5)* is based on section 157(1)(a) of CAA 1990. It sets out various types of control and connected persons sales to which this subsection applies.

1752. *Subsection (6)* is based on section 157(1)(b) of CAA 1990. It describes types of sale in which the sole or main benefit is to obtain a tax advantage.

Section 489: Giving effect to allowances

1753. This section is based on section 134(5) of CAA 1990. It deals with giving effect to dredging allowances.

Part 10: Assured tenancy allowances

Overview

1754. This Part provides for assured tenancy allowances. These can be writing-down allowances or balancing allowances. Balancing charges can recover "excessive allowances".

1755. Allowances are only available in relation to expenditure incurred after 9 March 1982 and before 1 April 1992, on dwelling-houses let on assured tenancies.

1756. Chapter 1 provides that both qualifying expenditure on a building and the existence of a qualifying dwelling-house are needed for allowances to be given. It sets out some conditions relating to when a building is a qualifying dwelling-house – further conditions are in Chapter 4. The Chapter also sets time limits on the qualifying expenditure that is eligible for allowances – further material on qualifying expenditure is in Chapter 3. The meaning of "approved body" is given. Expenditure attributable to land (rather than a building) cannot be construction expenditure. The treatment of expenditure on "capital repairs" is set out.

1757. Chapter 2 deals, in relation to construction expenditure, with the relevant interest in the building and the relevant interest in a dwelling-house comprised in the building. A person must have the relevant interest in a dwelling-house in order to claim allowances on qualifying expenditure.

1758. Chapter 3 deals, in relation to construction expenditure, with qualifying expenditure. Allowances can only be claimed if there is qualifying expenditure. Qualifying expenditure may not exist and it need not be the same as construction expenditure.

1759. Chapter 4 deals with some requirements for a dwelling-house to be a qualifying dwelling-house. Allowances are only given in relation to a qualifying dwelling-house. If a dwelling-house ceases to be a qualifying dwelling-house, otherwise than on the sale of the relevant interest, there is a deemed market-value sale of the relevant interest – which may result in appropriate balancing adjustments being made.

1760. Chapter 5 sets out the conditions to be satisfied for a person to get writing-down allowances. Only persons who are or have been approved bodies can have writing-down allowances for a chargeable period and then only if:

- that person has the relevant interest in a dwelling-house (Chapter 2);
- there is qualifying expenditure in relation to that dwelling-house (Chapters 1 and 3); and

- at the end of the chargeable period the dwelling-house is a qualifying dwelling-house (Chapters 1 and 4).

The Chapter also gives the calculation of writing-down allowances and the meaning of "qualifying expenditure attributable to a dwelling-house".

1761. Chapter 6 deals with balancing adjustments that can occur up to 25 years after the dwelling-house is first used. These balancing adjustments are either balancing allowances or balancing charges and are made to or on the person entitled to the relevant interest immediately before a balancing event. The Chapter deals with balancing events and the calculation of balancing adjustments.

1762. Chapter 7 sets out the calculation of the residue of qualifying expenditure appropriate to a dwelling-house. The concept of the residue is important as an allowance is limited to the residue of qualifying expenditure immediately before the allowance is made. The residue is also used in other Chapters in calculating the rate of writing-down allowances following transfers of the relevant interest and in the calculation of balancing adjustments.

1763. Chapter 8 explains how allowances and charges under this Part are made and contains supplementary material.

History

1764. A scheme of capital allowances was introduced in FA 1982 for expenditure on the construction of properties for letting on assured tenancies under the Housing Act 1980. Under that Act bodies approved by the Secretary of State could let property at freely-negotiated rents outside the provisions of the Rent Acts provided that certain conditions were met. The intention of the new allowance was to encourage the construction of new properties for letting to individuals by private bodies and to stimulate the construction industry. The legislation was based broadly on that for industrial buildings allowances with initial allowances at 75% and writing-down allowances at 4%. Initial allowances were withdrawn by FA 1984 over a period ending on 31 March 1986.

1765. Assured tenancies were introduced in the Housing Act 1980 for approved bodies. There was nothing to prevent an unincorporated body of persons, such as a partnership, from applying and approval was not refused merely on the grounds of non-corporate status. But the capital allowances were intended to be available only to companies so the definition of "qualifying dwelling-house" was amended with effect from 5 May 1983 to exclude landlords other than companies.

1766. The allowances as introduced were limited to qualifying expenditure incurred after 9 March 1982 and before 1 April 1987. FA 1987 extended this to expenditure incurred before 1 April 1992.

1767. The Housing Act 1988 introduced a new scheme of assured tenancies under which landlords no longer needed approval. This meant that changes were needed as approval of landlords was a feature of the system of assured tenancy allowances. FA 1988 therefore contained provisions to:

- prevent balancing charges arising purely as a result of changes made by the Housing Act 1988; and

- stop most expenditure after 14 March 1988 qualifying for relief.

Structure of this Part

1768. The legislation is not spent as writing-down allowances may continue for 25 years or more after expenditure was incurred. But there can be no *new* qualifying expenditure or *new* bodies that can claim writing-down allowances. Most (and possibly all) practical

issues have been resolved by now with writing-down allowances being claimed year by year.

1769. As these allowances were based largely on industrial buildings allowances, the same structure has, so far as possible, been adopted as in Part 3.

Chapter 1: Introduction

Section 490: Assured tenancy allowances

1770. This section is based on sections 84(1), 86(1), (2) and (4) and 97(1) of CAA 1990.

1771. It sets out the requirements for qualifying expenditure and a qualifying dwelling-house before allowances are available.

1772. The section gives part of the meaning of "qualifying dwelling-house" and a signpost to other provisions that deal with the concept of a qualifying dwelling-house.

1773. This section refers to a number of terms that are not defined in the Taxes Acts. Definitions, which are not exhaustive in all cases, are set out below.

Section 56(1) of the Housing Act 1980 (repealed with savings by the Housing Act 1988)

"A tenancy under which a dwelling-house is let as a separate dwelling is an assured tenancy and not a housing association tenancy (within the meaning of section 86 of the 1977 Act) or a protected tenancy if–

(a) the conditions described in section 56A or 56B are satisfied,

(b) the interest of the landlord has, since the creation of the tenancy, belonged to an approved body, and

(c) the tenancy would, when created, have been a protected tenancy or, as the case may be, a housing association tenancy but for this section."

1774. Section 56A of the Housing Act 1980 dealt with buildings erected after 7 August 1980. Section 56B of the Housing Act 1980 dealt with buildings to which works had been carried out and other conditions satisfied.

Section 1(1) of the Housing Act 1988

"A tenancy under which a dwelling-house is let as a separate dwelling is for the purposes of this Act an assured tenancy if and so long as–

(a) the tenant or, as the case may be, each of the joint tenants is an individual; and

(b) the tenant or, as the case may be, at least one of the joint tenants occupies the dwelling-house as his only or principal home; and

(c) the tenancy is not one which, by virtue of subsection (2) or subsection (6) below, cannot be an assured tenancy."

Section 18(1) of the Rent Act 1977

"Subject to sections 24(3) and 143 of this Act, a "regulated tenancy" is, for the purposes of this Act, a protected or statutory tenancy

Section 86(1) of the Rent Act 1977

"In this Part of this Act "housing association tenancy" means a tenancy to which this Part of this Act applies

Section 56(4) of the Housing Act 1980 (repealed with savings by the Housing Act 1988)

"In this Part of this Act "approved body" means a body, or one of a description of bodies, for the time being specified for the purposes of this Part of this Act in an order made by the Secretary of State.

Section 491: Allowances available in relation to old expenditure only

1775. This section is based on sections 84 and 96(3) of CAA 1990. It contains time limits regarding when qualifying expenditure is incurred if allowances are to be given under this Part. Expenditure must have been incurred by 31 March 1992 in order for allowances to be given in respect of it.

Section 492: Meaning of "approved body"

1776. This section is based on section 97(1) of CAA 1990. Section 56(4) of the Housing Act 1980 is set out above.

Section 493: Expenditure on the construction of a building

1777. This section is based on sections 93(1) and 97(2) of CAA 1990. It stops allowances being given for the cost of land and says how "capital repairs" are treated. There are similar provisions in Part 3.

Chapter 2: The relevant interest

Section 494: Introduction

1778. This section is a signpost that the Chapter deals, in relation to expenditure on constructing a building, first with the concept of the relevant interest in the building and then with the relevant interest in a dwelling-house comprised in the building. There may be more than one dwelling-house comprised in a building.

Section 495: General rule as to what is the relevant interest in the building

1779. This section is based on section 95(1) and (2) of CAA 1990.

1780. In relation to construction expenditure, the relevant interest is the interest in the building that the person incurring that expenditure holds when the expenditure is incurred.

1781. *Subsection (2)* signposts the fact that later provisions in this Chapter can modify the general rule

1782. *Subsection (3)* deals with the case in which the person incurring the construction expenditure holds more than one interest in the building.

Section 496: Interest acquired on completion of construction

1783. This section is based on section 97(3) of CAA 1990.

1784. It deals with the case in which the person incurring the construction expenditure becomes entitled to an interest in the building when construction is completed. Without this provision there might be no relevant interest because that person might have no interest in the building when the construction expenditure is incurred. The absence of a relevant interest could effectively deny relief for the cost of the building that might otherwise be available.

1785. There is added "or as a result of the" in paragraph (b). See *Change 34* in Annex 1. But this change is likely to have no effect for this Part as qualifying expenditure and the relevant interest have almost certainly been established many years ago.

Section 497: Effect of creation of subordinate interest

1786. This section is based on part of section 95(3) of CAA 1990. It provides that the relevant interest is not changed by the creation of a subordinate interest.

Section 498: Merger of leasehold interest

1787. This section is based on part of section 95(3) of CAA 1990. If the relevant interest is a leasehold interest, which merges in a way set out in the section, the relevant interest becomes the interest into which the leasehold merges.

Section 499: Provisions applying on termination of lease

1788. This section is based on section 94 of CAA 1990.

1789. *Subsection (1)* does not reproduce section 94(1)'s reference to "capital expenditure" as the expenditure in relation to which there is a relevant interest. The equivalent in this Act would have been "qualifying expenditure". But the different approach has no effect. If there is no qualifying expenditure there is nothing for this section, or Part, to act on.

1790. *Subsections (2)* and *(3)* treat a lease as continuing in certain circumstances. The rule prevents balancing adjustments being made in circumstances in which it would be inappropriate.

1791. *Subsection (4)* treats the relevant interest (the lease) as surrendered for consideration if the lessor makes certain payments to the lessee on the lease termination. Section 572(1)(b) will then treat the surrender of the lease as if it was a sale of the relevant interest. Section 514(a) then gives a balancing event on which any appropriate balancing adjustment can be made.

1792. *Subsection (5)* treats a new lease as the same lease as a terminated lease in the circumstances set out.

Section 500: The relevant interest in the dwelling-house

1793. This section is based on part of section 95(1) of CAA 1990.

Chapter 3: Qualifying expenditure

Section 501: Capital expenditure on construction

1794. This section is based on parts of sections 85(1) and (2) and 87(1) of CAA 1990. It sets out when the construction expenditure is qualifying expenditure.

Section 502: Purchase of unused dwelling-house used where developer not involved

1795. This section is based on parts of section 91(1) and (2) of CAA 1990. It gives the qualifying expenditure if the relevant interest in the building is sold before the dwelling-house is first used and no developer is involved.

1796. Section 91 of CAA 1990 is expressed to apply for the purposes of sections 85 to 90 of CAA 1990. But, as it is clear that section 91 is also meant to apply for the purpose of section 96, that limitation is omitted in this section. See *Note 65* in Annex 2.

Section 503: Purchase of dwelling-house sold unused by developer

1797. This section is based on parts of section 91(1) and (3) of CAA 1990. It gives the qualifying expenditure if the relevant interest in the building is sold before the dwelling-house is first used and a developer is involved.

1798. As in section 502 the limitation in section 91 of CAA 1990 is omitted. See *Note 65* in Annex 2.

Chapter 4: Qualifying dwelling-houses

Section 504: Requirements relating to the landlord

1799. This section is based on section 86(3) and (5) of CAA 1990. It sets out some of the conditions for a dwelling-house to be a qualifying dwelling-house. One of the conditions is that the landlord is a company (subject to a transitional exception).

Section 505: Qualifying dwelling-houses: exclusions

1800. This section is based on part of section 86(3) of CAA 1990. It gives circumstances in which a dwelling-house is not a qualifying dwelling-house.

Section 506: Dwelling-house ceasing to be qualifying dwelling-house

1801. This section is based on section 89 of CAA 1990. It allows a dwelling-house to continue to be treated as a qualifying dwelling-house during periods of temporary disuse. The section also ensures that a balancing adjustment can be made if a dwelling-house ceases to be a qualifying dwelling-house despite the fact that the relevant interest in the dwelling-house has not been sold.

Chapter 5: Writing-down allowances

Section 507: Entitlement to writing-down allowance

1802. This section is based on part of section 85(1) of CAA 1990. It sets out the conditions needed for a person to claim a writing-down allowance.

1803. *Subsection (2)* allows a claim for less than the full writing-down allowance. See *Change 38* in Annex 1.

Section 508: Basic rule for calculating amount of allowance

1804. This section is based on part of section 85(2) of CAA 1990. It gives the rate at which writing-down allowances are available if there has been no change under the following section.

Section 509: Calculation of allowance after sale of relevant interest

1805. This section is based on part of section 85(3) of CAA 1990. It gives a formula to work out the new rate at which writing-down allowances are available following a sale of the relevant interest on which a balancing adjustment falls to be made.

1806. *Subsection (2)* refers to the 25-year period beginning with the day on which the "dwelling-house" was first used in the definition of "B". But section 85(3) of CAA 1990 refers to the period beginning with the date on which the "building" was first used. Section 85(3) is not consistent with section 87(2) of CAA 1990 which limits the period during which balancing adjustments can be made by reference to first use of the dwelling-house. This section is rewritten on the basis that a mistake was made in section 85(3)'s reference to first use of the building. See *Note 66* in Annex 2.

Section 510: Allowance limited to residue of qualifying expenditure attributable to dwelling-house

1807. This section is based on section 85(4) of CAA 1990. It stops allowances from exceeding the qualifying expenditure in respect of which they are given.

Section 511: Qualifying expenditure attributable to dwelling-house

1808. This section is based on section 96(1) and (2) of CAA 1990. This Chapter calculates allowances by reference to the qualifying expenditure attributable to the dwelling-

house. This section sets out how to determine the qualifying expenditure attributable to a dwelling-house starting with the qualifying expenditure attributable to the building (found from Chapter 3). A limit is set on the qualifying expenditure attributable to a dwelling-house.

Section 512: Residue of qualifying expenditure attributable to dwelling-house

1809. This section is partly based on section 90(1) of CAA 1990. It gives a signpost to where details on the residue, which is referred to in this Chapter, can be found.

Chapter 6: Balancing adjustments

Section 513: When balancing adjustments are made

1810. This section is based on section 87(1) and (2) of CAA 1990. It sets out when balancing adjustments are made and who they are made to or on.

Section 514: Balancing events

1811. This section is based on parts of sections 87(1) and 150(4) of CAA 1990. It lists events which can trigger a balancing adjustment.

Section 515: Proceeds from balancing events

1812. This section is based on part of section 156 of CAA 1990. It sets out in tabular form the proceeds to be used in calculating the balancing adjustment.

Section 516: Dwelling-house a qualifying dwelling-house throughout

1813. This section is based on section 87(3) and (4) and part of section 88(1) of CAA 1990.

1814. It sets out the calculation of a balancing adjustment if the dwelling-house was always a qualifying dwelling-house while the person held the relevant interest. Essentially the balancing adjustment is found by a straight comparison of the proceeds against the residue.

Section 517: Dwelling-house not a qualifying dwelling-house throughout

1815. This section is based on section 88 of CAA 1990. It sets out the calculation of a balancing adjustment if the dwelling-house was not a qualifying dwelling-house for some of the time that the person held the relevant interest.

1816. The calculation starts by comparing the proceeds with the person's "starting expenditure". The "starting expenditure" is defined in section 521.

1817. If the proceeds exceed or equal the starting expenditure, all allowances given to the person are recaptured by a balancing charge.

1818. If the proceeds are less than the starting expenditure then the person has broadly suffered a "loss" on the dwelling-house. This "loss" is pro-rated to the part of the person's period of ownership during which the dwelling-house was a qualifying dwelling-house. There is a formula for this in section 522 and the result is called the adjusted net cost.

1819. Then there is a balancing allowance or balancing charge, as the case may be, based on whether the adjusted net cost is more (allowance) or less (charge) than the allowances given to the person. The adjustment is the difference between the proceeds and the adjusted net cost.

Section 518: Overall limit on balancing charge

1820. This section is based on section 87(6) of CAA 1990. It limits balancing charges on a person to allowances given to that person.

Section 519: Recovery of old initial allowances made on incorrect assumptions

1821. This section is based on section 87(7) and (8) of CAA 1990. It ensures that initial allowances made under earlier provisions can be withdrawn if the dwelling-house has not yet been used and turns out not to be a qualifying dwelling-house when it is first used. This is a transitional provision which, as time goes by, is increasingly unlikely to be needed.

Section 520: The relevant period of ownership

1822. This section is based on section 88(5) of CAA 1990 ("the relevant period").

Section 521: Starting expenditure

1823. This section is based on section 88(5) of CAA 1990 ("the capital expenditure"). There seems to be an obvious mistake in section 88(5) as it must have been intended to define "the capital expenditure *appropriate to the dwelling-house*" which is the term used in section 88(2). This section is rewritten to correct that mistake.

Section 522: Adjusted net cost

1824. This section is based on section 88(5) of CAA 1990.

Chapter 7: Writing off qualifying expenditure attributable to dwelling-house

Section 523: Introduction

1825. This section is based on part of section 90(1) of CAA 1990. It is a signpost to the fact that the residue of qualifying expenditure appropriate to a dwelling-house varies with the time at which it is to be found. The residue is found by starting with the qualifying expenditure appropriate to the dwelling-house and making any adjustments required by this Chapter up to the time concerned.

Section 524: Writing off initial allowances

1826. This section is based on section 90(2) of CAA 1990. It writes off any initial allowances that were made in respect of the qualifying expenditure attributable to the dwelling-house. The write off occurs when the dwelling-house is first used.

Section 525: Writing off writing-down allowances

1827. This section is based on section 90(3) and (4) of CAA 1990. It writes off any writing-down allowances that were made in respect of the qualifying expenditure attributable to the dwelling-house. The write off occurs at the end of the chargeable period for which the allowance is given.

1828. *Subsection (2)* clarifies the order in which adjustments to the residue must be made in the unusual case in which a balancing event also occurs at the end of the chargeable period.

Section 526: Writing off expenditure for periods when building not used as qualifying dwelling-house

1829. This section is based on section 90(5) of CAA 1990. It writes off part of the qualifying expenditure attributable to the dwelling-house for any period, after it is first used, during which the dwelling-house is not a qualifying dwelling-house. The write off is at the rate at which writing-down allowances could have been given during that period if the dwelling-house had been a qualifying dwelling-house.

1830. The rate at which writing-down allowances could have been given might vary during the period when the dwelling-house is not a qualifying dwelling-house. If so, the write

off is found by splitting the period into periods during which the rate is the same and adding together the write-offs appropriate to each of those periods.

Section 527: Writing off or increase of expenditure where balancing adjustment made

1831. This section is based on section 90(6) to (8) of CAA 1990. It increases the residue of qualifying expenditure attributable to the dwelling-house by any balancing charge and reduces it by any balancing allowance made when the relevant interest is sold. The adjustment is made at the time when the relevant interest is sold.

1832. *Subsection (4)* makes sure that this section cannot result in the purchaser of the relevant interest "inheriting" a residue of qualifying expenditure greater than the price the purchaser effectively paid for the dwelling-house.

Section 528: Treatment of demolition costs

1833. This section is based on section 90(9) of CAA 1990. It allows the net cost of demolition of the dwelling-house to be added to the residue immediately before the demolition occurs if a balancing adjustment may occur on the demolition. This increase in the residue permits appropriate relief for the demolition costs in working out the balancing adjustment under Chapter 6.

Chapter 8: Supplementary provisions

Section 529: Giving effect to allowances and charges

1834. This section is based on section 92 of CAA 1990 and parts of sections 140(2), 144(2) and 161(5) of CAA 1990.

1835. It sets out how allowances are given and charges are made. Section 92(1) of CAA 1990 is not rewritten. See *Note 67* in Annex 2.

Section 530: Apportionment of sums partly referable to non-qualifying assets

1836. This section is based on section 97(4) of CAA 1990.

1837. The price paid for the relevant interest in the building may be attributable to things other than construction expenditure in relation to which relief may be given under this Part. For instance, an element of the price will usually be attributable to land. This section allows appropriate apportionments to be made of the price paid.

1838. Apportionment is also allowed for insurance receipts (and so on) – which are not sale proceeds. This prevents proceeds coming into the calculation of balancing adjustments to the extent that the proceeds are attributable to expenditure for which no relief can be given.

1839. *Subsection (1)* omits the reference to "or structure" contained in section 97(4) of CAA 1990. That was a mistake because those words are not relevant to Part IV of CAA 1990 although the equivalent words in section 21(3) of CAA 1990 are relevant to Part I of CAA 1990.

1840. *Subsection (1)* uses the term "just and reasonable apportionment". Section 97(4) on which it is based uses "just apportionment". This is a change. See *Change 40* in Annex 1.

Section 531: Meaning of "dwelling-house", "lease" etc.

1841. This section is based on section 97(1) ("dwelling-house") of CAA 1990 and sections 161(2) and 162 of CAA 1990.

Part 11: Contributions

Overview

1842. This Part deals with contributions one person (the contributor "C") makes to expenditure by another person (the recipient "R").

1843. Chapter 1 generally stops the recipient (R) getting capital allowances on expenditure met by the contributor (C). But there are exceptions to this general rule.

1844. Chapter 2 enables the contributor (C) to get capital allowances under Parts 2 to 5 for a contribution in some cases.

Background

1845. ITA 1945 introduced provisions to deny allowances if expenditure was met by a grant or other capital contribution. But exceptions were made to this for:

- insurance or other compensation; and
- contributions (other than government grants and the like) from someone who could not get capital allowances on them under the provisions for contributors.

1846. The legislation for contributors gave the contributor (C) entitlement to:

- plant and machinery allowances;
- industrial buildings allowances;
- agricultural buildings allowances; or
- mineral extraction allowances;

for capital contributions for the purposes of the contributor's trade, or a trade carried on by the contributor's tenant, if the contribution met certain conditions. The main conditions were that:

- the recipient (R) would have been entitled to allowances but for the rule described in paragraph 1845; and
- the contributor (C) would have been entitled to allowances if C had incurred the expenditure on a similar asset.

1847. Similar legislation was included in section 17 of FA 1956 which introduced allowances for dredging.

1848. This broad approach remains in sections 153 to 155 of CAA 1990 and (for dredging) section 134(8) of CAA 1990. But sections 153 to 155 incorporate various changes since 1945. The main changes were:

- FA 1971 revised the legislation enabling the contributor (C) to get plant and machinery allowances to take account of the introduction of pooling; and
- FA 1989 (in preparation for consolidation in CAA 1990):
  - — extended the provisions to professions and vocations as for trades;
  - — denied the recipient (R) allowances if the contributor (C) could get tax relief for the contribution as a trading expense; and
  - — required contributions on which the contributor (C) claimed plant and machinery allowances to be allocated to a separate pool.

Chapter 1: Exclusion of expenditure met by contributions

Overview

1849. This Chapter gives the rules for contributions for a recipient (R).

1850. Section 532 is the general rule. The recipient (R) is not treated as incurring expenditure if it is met by a contribution. This section does not apply for dredging but section 533 gives a similar rule for that.

1851. Sections 534 to 536 are exceptions to the general rule in section 532 for:

- Northern Ireland regional development grants;
- insurance or other compensation; and
- some contributions by persons (other than public bodies) who cannot get tax relief for them.

Section 532: The general rule excluding contributions

1852. This section is based on parts of sections 153(1) and (4) and 134(8) of CAA 1990 together with part of section 532(1) of ICTA. It gives the general rule excluding contributions from expenditure for the purposes of all Parts other than Part 9. It also defines "public body" for the purposes of Chapter 1.

1853. Section 532(1) of ICTA treats sections 520 to 531 and 533 as if they were contained in CAA 1990.

Section 533: Exclusion of contributions to dredging

1854. This section is based on section 134(8) of CAA 1990. It gives the rule excluding contributions to expenditure on dredging.

Section 534: Northern Ireland regional development grants

1855. This is the first of three sections which make exceptions to the general rule in section 532. It is based on parts of section 153(1) of CAA 1990 and section 137 of FA 1982. It leaves expenditure met by Northern Ireland regional development grants to qualify for capital allowances (if, of course, the necessary conditions are met).

1856. *Subsection (1)* uses the term "Northern Ireland legislation". This term is defined by Schedule 1 and section 24(5) of the Interpretation Act 1978. Paragraph 3 of Schedule 13 to the Northern Ireland Act 1998 provides an amendment which would cover Acts of the Assembly.

1857. *Subsections (2)* and *(3)* are based on section 137 of FA 1982. Their effect is that the general rule in section 532 excluding contributions does apply (despite subsection (1)) if a grant is "netted off" by paragraph 8 of Schedule 3 to OTA 1975 for the purposes of arriving at expenditure for petroleum revenue tax relief. In summary, in these particular circumstances the recipient (R) cannot get capital allowances.

1858. Subsection (3) deals with a subset of these cases if part of the expenditure met by the grant would have qualified for petroleum revenue tax relief (but for paragraph 8) and part would not have. The part which would not have qualified for relief is left for the "normal" capital allowances rules to apply. In summary, the recipient (R) may be able to get capital allowances for that part of the grant.

1859. Paragraph 106 of Schedule 3 maintains other provisions relating to this exception which have at most only transitional effect.

Section 535: Insurance or compensation money

1860. This section is based on part of section 153(2) of CAA 1990. It excludes from the general rule insurance or other compensation payable in respect of the destruction of an asset and similar disposal events.

1861. There is a minor change. In CAA 1990 this exception does not apply for Part VII (R&D allowances). This Act applies the exception to Part 6 (R&D allowances). So expenditure is not denied R&D allowances because it was met by insurance or the like. See *Change 58* in Annex 1.

Section 536: Contributions not made by public bodies and not eligible for tax relief

1862. This section is based mainly on section 153(2) and (3) of CAA 1990. It excludes contributions from the general rule (and so leaves the recipient (R) with expenditure which might qualify for allowances) if the conditions in subsections (2) and (3) are met. There are two minor changes.

1863. *Subsections (3)* and *(5)* are based on section 153(2)(b) of CAA 1990. In sections 153 to 155 of CAA 1990 there are explicit references to a profession or vocation as well as a trade. But Part II of CAA 1990 treats some other activities ("qualifying activities" in Part 2 of this Act) as trades for various purposes.

1864. Section 27, which treats professions and vocations (and offices and employments) like trades, does so only for the purposes of Part II of CAA 1990. So "trade" in sections 153 to 155 of CAA 1990 clearly does not have its meaning extended by section 27 (although as mentioned above it is explicitly extended to mean also profession and vocation).

1865. Sections 28, 28A and 29 of CAA 1990 deem other things to be trades. Their effect is not limited in the same way to Part II of CAA 1990. So whether or not "trade" in sections 153 to 155 includes them is not clear. This affects both the contributor (C) and the recipient (R) (because if C's activity is included it may mean R cannot get allowances).

1866. This Act replaces these deemed trades by qualifying activities in Part 2. As a result this Part makes explicit the activities to which it applies for the purposes of plant and machinery allowances. Subsection (5) does this. See *Change 59* in Annex 1.

1867. In section 153 of CAA 1990 this exception does not apply for Part VII (R&D allowances). In this Act it does. As with paragraph 1861 above, see *Change 58* in Annex 1.

1868. Section 126(4) of FA 1990 makes a similar exception for contributions out of certain pools payments. That legislation is not incorporated in this Act as the likelihood of contributions being made now is very small. Section 126(4) will, however, continue in force should there be any such contributions in periods covered by this legislation.

1869. Paragraph 107 of Schedule 3 maintains the transitional provisions in section 153(5) of CAA 1990 for contributions made before 27 July 1989.

1870. "Public body" is defined in section 532.

Chapter 2: Contribution allowances

Overview

1871. This Chapter enables certain contributions to another person's expenditure to qualify for allowances under Parts 2 to 5 and Part 9.

1872. Section 537 gives the general conditions which have to be satisfied for contributions to be able to lead to allowances under Parts 2 to 5.

1873. Sections 538 to 541 then give additional details relevant to each of those Parts in turn.

1874. Section 542 provides for allowances to be given on contributions after the transfer of a trade or relevant activity.

1875. Section 543 provides allowances for contributions for dredging.

Section 537: Conditions for contribution allowances under Parts 2 to 5

1876. This section is based on parts of section 154 of CAA 1990. It gives the general conditions which have to be met if a contributor (C) is to be able to get allowances under Parts 2 to 5 for a contribution.

1877. Section 154 of CAA 1990 applies explicitly to trades, professions and vocations. Subsection (4) applies for this Chapter the explicit list of activities in section 536(5). See paragraph 1866 above and *Change 59* in Annex 1.

Section 538: Plant and machinery

1878. This section is based mainly on sections 154(2) and 155(6) of CAA 1990 together with parts of sections 154(1) and 155(2) and (3) of CAA 1990. If the conditions in subsection (1) are met, the contributor (C) is treated by subsection (2) as incurring expenditure on, owning and using R's asset. This means the contributor (C) meets some of the conditions for plant and machinery allowances which otherwise would mean the contributor (C) had no entitlement. It does not mean the contributor (C) is necessarily entitled to plant and machinery allowances. For example the asset must still be plant or machinery.

1879. There is a minor change. *Subsection (3)* requires expenditure to be allocated to a single asset pool. This was the intention in 1989 (in what became, on consolidation, section 155(6) of CAA 1990) in order that plant and machinery allowances for a contribution could be given to a successor if part of a trade was transferred. But the fact that the expenditure is meant to be allocated to a single asset pool was not achieved unambiguously. See *Change 60* in Annex 1.

1880. The general rule for single asset pools for contributions expenditure now covers contributions to expensive cars, in contrast to section 35(1) of CAA 1990 which handles them separately. See *Note 19* in Annex 2.

1881. *Subsections (4)* to *(6)* provide for allowances in respect of contributions to be given to a successor when an activity or part of an activity is transferred.

1882. The single asset pool for contributions expenditure on plant and machinery leads to writing-down allowances at 25%, 10% or 6% as appropriate. Sections 102(2) and 109(3) apply to all types of single asset pools. See *Note 23* in Annex 2.

1883. By providing explicitly for property businesses to be "relevant activities" for the purposes of Part 2 it is not necessary for this Act to make specific provision for plant and machinery allowances for a landlord's contributions to expenditure for the purposes of a tenant's trade. See *Note 68* in Annex 2.

Section 539: Industrial buildings

1884. This section is based on section 154(1) and parts of section 155 of CAA 1990. If the conditions in subsection (1) are met, the contributor (C) is treated by subsection (2) as incurring expenditure on, and using, a similar asset to R's.

1885. *Subsections (3)* to *(6)* provide for entitlement to industrial buildings allowances in respect of contributions made for the purposes of a tenant's trade to go with the relevant interest held by C.

Example

Trader R builds a factory on land R rents from C. C makes a contribution towards R's expenditure on the construction of the factory for the purposes of R's trade. The factory is used for a qualifying trade and R is entitled to industrial buildings allowances.

C can claim industrial buildings allowances as if the contribution had been expenditure on a similar factory.

C subsequently (within the writing-down period) sells the land to D. Then D is entitled to industrial buildings allowances for the chargeable period in which the transfer take place and subsequent chargeable periods.

Section 540: Agricultural buildings

1886. This section is very similar to section 539. But, on a transfer of a landlord's relevant interest, the provisions of Part 4 apply in place of those for Part 3.

1887. Paragraph 110 of Schedule 3 maintains the effect of section 155(7) of CAA 1990 which can only have effect in relation to contributions made before 27 July 1989.

Section 541: Mineral extraction

1888. This section is similar to sections 539 and 540. But it is not necessary to provide for mineral extraction allowances for a landlord's contribution for the purposes of a tenant's trade. Mineral extraction allowances are only available to persons carrying on a trade. See *Note 68* in Annex 2.

Section 542: Transfer of C's trade or relevant activity

1889. This section is based on section 155(3) of CAA 1990. It provides for allowances under Parts 3 to 5 in respect of contributions for the purposes of a trade or other activity to be given to a successor if the activity is transferred.

Section 543: Contribution allowances under Part 9

1890. This section is based on part of section 134(8) of CAA 1990. It provides for allowances for contributions to expenditure on dredging.

Part 12: Supplementary provisions

Overview

1891. Part 12 contains provisions which do not fit naturally into other Parts. These are:

- particular provisions for life assurance business (Chapter 1);
- general provisions about additional VAT liabilities and repayments under the capital goods scheme (Chapter 2);
- definitions about oil and oil licences and related matters (Chapter 3);
- provisions for partnerships, successions and transfers (Chapter 4);
- provisions for apportionments of proceeds from sales (for example) and other miscellaneous matters (Chapter 5); and
- final provisions for the Act (Chapter 6).

Chapter 1: Life assurance business

Overview

1892. This Chapter makes provisions for companies carrying on life assurance business:

- section 544 defines "management asset" and provides that there are no capital allowances on them other than plant and machinery allowances; and
- section 544 defines "investment asset" and provides for capital allowances on them to be apportioned between categories of business.

Section 544: Management assets

1893. This section is based on section 434D(1), (2) and (7) of ICTA. It defines "management asset" and restricts the availability of allowances for management assets.

1894. *Subsection (4)* ensures that "expenses of management within section 76 of ICTA" is given the intended meaning by disregarding section 76(1)(d). See *Note 69* in Annex 2.

Section 545: Investment assets

1895. This section is based on section 434E(1), (4) and (5) of ICTA. It defines "investment asset" and sets out rules for the allocation and availability of allowances for investment assets.

1896. *Subsections (1)* and *(2)* define "investment asset" as any asset held by a company carrying on any life assurance business other than a management asset. This is a change to the definition in section 434E(1), since there is no reference here to property businesses. See *Change 61* in Annex 1.

1897. *Subsection (3)* requires any allowances in respect of investment assets to be apportioned between the categories of insurance business in the same way that income relating to the asset would be apportioned.

1898. *Subsection (4)* provides that capital allowances on investment assets are not available if the life assurance business is charged to tax under Case I of Schedule D, so that allowances are only available if the company is charged to tax on the I-E basis.

1899. *Subsection (5)* provides that capital allowances on investment assets are not taken into account in calculating the profits of the company's pension business, life reinsurance business or overseas life assurance business. So, allowances on investment assets are only available in calculating the profits from the company's BLAGAB.

Chapter 2: Additional VAT liabilities and rebates: interpretation, etc.

Overview

1900. This Chapter provides the interpretation for the provisions in Parts 2, 3 and 6 dealing with additional VAT liabilities and rebates. It is based on section 159A of CAA 1990.

1901. These provisions apply if taxpayers are required to make adjustments under the VAT capital items legislation (commonly known as the capital goods scheme) which is dealt with in regulations 112 to 116 of VAT Regulations 1995 (SI 1995/2518)).

Background

1902. The capital goods scheme is relevant to businesses that, under VAT legislation, make both exempt and non-exempt supplies. These traders are known as "partially exempt traders". When a VAT-registered business incurs VAT on its purchases (input tax), it can usually offset these amounts against the tax it owes to HM Customs & Excise on its

sales (output tax). However, partially-exempt businesses are not able to do so in respect of purchases attributable to exempt sales (or "supplies").

1903. Generally with VAT, the rules for capital expenditure do not differ from the rules for revenue items. However, the capital goods scheme is an exception. For certain types of capital expenditure, it is necessary for partially-exempt businesses to make an annual adjustment over a period of five or ten years so that the reclaimable input tax reflects the proportion of use attributable to the making of non-exempt supplies during the period.

1904. The types of expenditure covered by the scheme can be broadly divided into three categories:

- computers or computer equipment worth £50,000 or more;
- land and buildings worth £250,000 or more; and
- building works worth £250,000 or more.

Adjustments are made over a five-year period in respect of the first category; and they are made over a ten-year period in respect of the other categories.

1905. It is a general principle of income tax and corporation tax that any non-recoverable VAT should be relieved as a cost for direct tax purposes. When the capital goods scheme was introduced in 1990, it became necessary to ensure that the capital allowances provisions could cater for VAT adjustments made under the Scheme so far as they related to expenditure covered by CAA 1990. The legislation to do this was introduced in FA 1991. And to simplify matters, the legislation was only introduced to cover cases in which the original expenditure was covered by the rules for plant and machinery allowances, industrial buildings allowances or R&D allowances.

1906. Broadly under these rules, if a taxpayer incurs an additional VAT liability (because the proportion of exempt use has risen) then the additional VAT liability is treated as additional capital expenditure incurred. And if a taxpayer receives an additional VAT rebate (because the proportion of exempt use has fallen) then the taxpayer is treated as receiving disposal proceeds equal to the amount received. However, the rules differ between the various Parts. This reflects the different schemes for allowances and charges under these Parts.

Section 546: Introduction

1907. This section is new and introduces the Chapter.

Section 547: "Additional VAT liability" and "additional VAT rebate"

1908. This section is based on section 159A(6) of CAA 1990. It provides a definition of the terms "additional VAT liability" and "additional VAT rebate".

Sections 548 and 549: Time when additional VAT liability or rebate is incurred, made, accrues etc.

1909. These sections are based on section 159A of CAA 1990. They determine when additional VAT liabilities and rebates are treated as arising.

1910. Section 159A(1) to (4) of CAA 1990 determines when additional VAT liabilities and rebates are treated as arising for the purposes of CAA 1990. It is clear that such rules are necessary to ensure that calculations of allowances and charges reflect the additional VAT liabilities and rebates in the correct chargeable periods.

1911. The legislation, however, provides two different sets of rules to determine the time an additional VAT liability or rebate is treated as arising. One of these sets of rules is applied when determining in which chargeable period a liability or rebate is to be brought into account (or for which chargeable period an allowance or charge is to be

made under the 1990 Act). The other set of rules is used in all other circumstances. In particular, it is used when the legislation requires certain conditions to be met at the time when the additional VAT liability or rebate arises.

1912. However, there are instances in which the same terminology is used with two different meanings in the same sentence. This Act has removed this obstacle to the understanding of the rules and uses two different labels to refer to the two different sets of rules.

1913. The time, determined in CAA 1990 by section 159A(1) and (2), is now referred to as the time when the additional VAT liability is incurred or the additional VAT rebate is made. This is the meaning that applies in all cases except when determining the chargeable period in which a liability or rebate is to be brought into account (or for which chargeable period an allowance or charge is to be made under the 1990 Act). This is dealt with in section 548.

1914. The time, determined in CAA 1990 by section 159A(3) and (4), is now referred to as the time when the additional VAT liability or rebate accrues. This is dealt with in section 549. This time will generally be later than the time determined in section 548.

1915. One advantage of using the later time in the legislation is to ensure that the appropriate capital allowances calculations do not generally need to be made until after the adjustment has been calculated for VAT purposes.

1916. Section 159A(4) of CAA 1990 may appear to determine only the chargeable period in which the additional VAT liability or rebate arises (or in the language of the new Act "accrues"). But CAA 1990 requires in various provisions the time (rather than just the chargeable period) in which the additional VAT liability or rebate accrues. This Act provides this. See *Note 70* in Annex 2.

Section 550: Apportionment of additional VAT liabilities and rebates

1917. This section is based on section 159A(5) and part of section 159A(7) of CAA 1990. It deals with cases in which it is necessary to apportion either the qualifying expenditure or the allowances or charges arising.

1918. In such cases, any additional VAT liability or rebate is subject to the same apportionment.

Section 551: Supplementary

1919. This section is based on section 159A(6) and part of section 159A(7) of CAA 1990. It provides definitions of terms used in the Chapter.

Chapter 3: Disposals of oil licences: Provisions relating to Parts 5 and 6

Overview

1920. This Chapter provides rules relating to the disposal of oil licences for the purposes of Parts 5 (mineral extraction) and 6 (research and development).

1921. These rules, whilst important to those concerned with the oil industry, are likely to be used by a minority of the users of either Part 5 or 6. They are dealt with here as they share many definitions in common but do not belong naturally in either Part 5 or Part 6.

1922. The rules require the "seller" and "purchaser" of certain interests in oil licences, related to undeveloped areas, to treat part of the consideration as having nil value. They also provide for the "recapture/reduction" of R&D allowances in certain cases in which an oil licence is disposed of.

Section 552: Meaning of "oil licence" and "interest in an oil licence"

1923. This section is based on sections 118A(4) and 138A(4) of CAA 1990, section 12(1) of OTA 1975 and section 196(5) of TCGA 1992.

1924. The section provides definitions for the purposes of this Chapter. Unlike section 118A(4) of CAA 1990 there is no reliance on cross-references to section 194 of TCGA 1992.

Section 553: Consideration to be treated as nil

1925. This section is based on parts of section 118A of CAA 1990 and section 196 of TCGA 1992. Section 118A is in Part IV of CAA 1990 but also has effect for Part VII of CAA 1990.

1926. The section treats certain consideration as having no value on the disposal of an oil licence relating to an undeveloped area.

1927. Disregarding some of the consideration affects the allowances and charges in Parts 5 and 6 that are associated with the acquisition or disposal of the oil licence concerned. Broadly, the "seller" may suffer a lower balancing charge and the purchaser may get lower allowances if this section applies.

1928. *Subsection (3)* might seem to use a different definition of "material disposal" from section 118A(2) of CAA 1990 but this is not the case. See *Note 71* of Annex 2.

Section 554: Circumstances in which oil licence relates to undeveloped area

1929. This section is based on section 118A(4) of CAA 1990, section 12(1) of OTA 1975 and section 196 of TCGA 1992. It determines when an oil licence relates to an undeveloped area without using a cross-reference to section 194 of TCGA 1992.

Section 555: Disposal of oil licence with exploitation value

1930. This section is based on section 138A of CAA 1990.

1931. When the section applies, part of the consideration for the oil licence is treated for the purpose of Part 6 (research and development) as if it were for the disposal of an asset representing qualifying expenditure. That treatment can lead to a recapture of R&D allowances given in relation to that qualifying expenditure.

Section 556: Minor definitions

1932. This section is based on sections 64A(12), 118A(4) and 138A(4) of CAA 1990, sections 1(1) and 12(1) of OTA 1975 and section 196 of TCGA 1992. It deals with minor definitions for the purposes of this Chapter.

Chapter 4: Partnerships, successions and transfers

Overview

1933. This Chapter provides rules for the transfer of and succession to trades and for the continuity of partnerships.

1934. Section 557 gives the application of sections 558 and 559. Section 558 provides for the continuity of allowances to partnerships. Section 559 deals with transfers on succession without sale.

1935. Section 560 provides rules for the transfer of insurance company businesses and section 561 deals with the transfer of a UK trade from a company resident in one European Union member state to a company resident in another.

Background

1936. There are other rules for successions elsewhere in this Act. In Part 2, sections 263 and 265 provide parallel provisions to sections 557 to 559. Section 343(2) of ICTA also provides for capital allowances to be given to a successor company in some circumstances. That provision is left in ICTA so that readers see there the full provisions for company reconstructions. But the text of section 343(1) and (2) is given below for ease of reference.

Section 343 Company reconstructions without a change of ownership

"(1) Where, on a company ("the predecessor") ceasing to carry on a trade, another company ("the successor") begins to carry it on, and—

(a) on or at any time within two years after that event the trade or an interest amounting to not less than a three-fourths share in it belongs to the same persons as the trade or such an interest belonged to at some time within a year before that event; and

(b) the trade is not, within the period taken for the comparison under paragraph (a) above, carried on otherwise than by a company which is within the charge to tax in respect of it;

then the Corporation Tax Acts shall have effect subject to subsections (2) to (6) below.

In paragraphs (a) and (b) above references to the trade shall apply also to any other trade of which the activities comprise the activities of the first mentioned trade.

(2) The trade shall not be treated as permanently discontinued nor a new trade as set up and commenced for the purpose of the allowances and charges provided for by the Capital Allowances Acts; but—

(a) there shall be made to or on the successor in accordance with those Acts all such allowances and charges as would, if the predecessor had continued to carry on the trade, have fallen to be made to or on it; and

(b) the amount of any such allowance or charge shall be computed as if—

(i) the successor had been carrying on the trade since the predecessor began to do so, and

(ii) everything done to or by the predecessor had been done to or by the successor (but so that no sale or transfer which on the transfer of the trade is made to the successor by the predecessor of any assets in use for the purpose of the trade shall be treated as giving rise to any such allowance or charge).

The preceding provisions of this subsection shall not apply if the successor is a dual resident investing company (within the meaning of section 404) which begins to carry on the trade after 31st March 1987.

Section 557: Application of sections 558 and 559

1937. This section is based on section 152 of CAA 1990. It sets out the Parts of this Act to which sections 558 and 559 do not apply.

1938. These are Parts 2, 6 and 10 (plant and machinery, research and development, and assured tenancies). Those Parts have separate rules.

Section 558: Effect of partnership changes

1939. This section is based on section 152(3) of CAA 1990. It provides for continuity of allowances if the members of a partnership change.

1940. Subsection (5) contains a change because of its application to property businesses. See *Change 62* in Annex 1.

Section 559: Effect of successions

1941. This section is based on section 152(1) and (2) of CAA 1990. If an asset is transferred on succession, without a sale of the asset and the succession is following a deemed discontinuance, then the transfer is treated as a sale at market value.

1942. It does not apply to plant and machinery but section 265 provides a similar rule. See paragraph 911 above.

1943. If the succession is between connected persons then an election under section 569 may be available to substitute a lower figure. See paragraph 1973 below.

1944. *Subsection (5)* contains a change because of its application to property businesses. See *Change 62* in Annex 1.

Section 560: Transfer of insurance company business

1945. This section is based on section 152A of CAA 1990. It provides what is known as a "step-in-shoes" rule for transfers of insurance company businesses.

1946. The transfer has to be approved by a court under Part I of Schedule 2C to the Insurance Companies Act 1982 or be a qualifying overseas transfer within paragraph 4A of Schedule 19AC to ICTA.

Section 561: Transfer of a UK trade to a company in another member State

1947. This section is based on section 152B of CAA 1990. It provides a "step-in-shoes" rule for the transfer of a UK trade if it is transferred from a company resident in one member state to a company resident in another.

1948. This section cannot apply unless section 140A of TCGA 1992 applies so it needs to be read with sections 140A and 140B of TCGA 1992.

Chapter 5: Miscellaneous

Overview

1949. This Chapter provides miscellaneous provisions which apply to the whole Act or to several Parts of it.

1950. Section 562 deals with apportionments if property is sold together.

1951. Sections 563 and 564 provide a procedure for determining certain questions affecting two or more persons.

1952. Section 565 deals with tax agreements for income tax purposes.

1953. Section 566 provides a special rule for companies not resident in the UK.

1954. Sections 567 to 570 provide for market value if sales are between connected persons or are transactions to obtain a tax advantage. They also provide for an election (if the sale is not a transaction to obtain a tax advantage) which will allow the price to be the amount of unused capital allowances.

Section 562: Apportionment where property sold together

1955. This section is based on section 150 of CAA 1990. It provides that if property is sold with other property the net proceeds are apportioned on a just and reasonable basis.

1956. Use of "just and reasonable apportionment" is a change from section 150(1) of CAA 1990 which uses "just apportionment". See *Change 40* in Annex 1.

1957. All property sold as part of one bargain is treated as sold together.

1958. There is nothing in this section to reflect section 150(5) of CAA 1990. It has not been rewritten. See *Note 72* in Annex 2

Section 563: Procedure for determining certain questions affecting two or more persons

1959. This section and section 564 are based on section 151 of CAA 1990. They provide for apportionments which affect two or more persons to be decided by one body of appeal Commissioners in one hearing.

Section 564 Questions to which procedure in section 563 applies

1960. *Section 564* sets out the general cases in which the procedure in section 563 applies to decide:

- apportionment of a sum for Parts 3 to 12; and
- market value for Part 2 and the other provisions listed.

1961. The procedure in section 563 is also applied in two other, particular circumstances over and above these general types which it would not be helpful to deal with here. See sections 357(6) and 561(4).

1962. The omission of Part 2 (plant and machinery) from *subsection (1)* might be thought odd. But there is no need for the procedure in section 563 for Part 2 generally. It is only directly relevant for market value – dealt with by subsection (2)(a). The procedure in section 563 could, however, apply to of plant and machinery indirectly. For example on a sale of plant and machinery with other property, the sale proceeds would fall to be apportioned under section 562. That apportionment could affect the tax of both the buyer and seller.

1963. *Subsection (4)* applies section 564 to cases procedures in which section 561(3) applies. This is a change because section 152B of CAA 1990 (which is the origin of section 561) contains its own apportionment arbitration rules. See *Change 63* in Annex 1.

Section 565: Tax agreements for income tax purposes

1964. This section is based on section 143 of CAA 1990. It provides that a tax agreement for income tax purposes, without assessment, treats an allowance as if given effect under an assessment.

Section 566: Companies not resident in the United Kingdom

1965. This section is based on section 149 of CAA 1990. It provides that capital allowances for companies not resident in the UK are given effect against income chargeable from the source of income to which the capital allowances are related.

Section 567: Sales treated as being for alternative amount: introductory

1966. This section is based on section 157(1)(a) of CAA 1990. It applies sections 568 to 570 and defines the tests – control and tax advantage – which decide if they can apply.

1967. *Subsection (2)* defines the “control test”. This is not a term used in this Act outside sections 567 to 570.

1968. *Subsection (3)* clarifies “body or persons” in subsection (2).

1969. *Subsection (4)* defines the “tax advantage test” for the purposes of these sections. This term is also not used elsewhere in the Act.

1970. *Subsection (5)* introduces the rule from section 152B(10) of CAA 1990 that section 157 shall not apply if section 152B applies (transfer of a UK trade, rewritten in section 561).

1971. Section 157(3) of CAA 1990 is not rewritten. This is because this section and sections 569 and 570 clearly apply to non-resident persons without an explicit statement to that effect. See *Note 73* in Annex 2.

Section 568: Sales treated as being at market value

1972. This section is based on section 157(4) of CAA 1990. It treats a sale as being at market value if either the control test or tax advantage test is met.

Section 569: Election to treat sale as being for alternative amount

1973. This section is based on section 158 of CAA 1990. It provides for an election to be made by connected persons to substitute the alternative amount for the market value of an asset given by section 568 if the control test is met but the tax advantage test is not.

1974. *Subsection (2)* makes clear this is subject to section 570 which prevents an election in some circumstances.

Section 570: Elections: supplemental

1975. This section is based on section 158 of CAA 1990. It prevents an election under section 569 in some circumstances.

1976. *Subsection (1)* is based on section 158(5) of CAA 1990. It means an election cannot be made if the sale is a relevant sale for Part 4 (agricultural buildings).

1977. *Subsection (2)* is based on section 158(3)(a) and (b) of CAA 1990. It prevents elections if, broadly speaking, the qualifying expenditure does not stay within the United Kingdom tax net.

1978. *Subsection (3)* is based on section 158(3)(a) or CAA 1990. It defines "relevant allowance or charge" for the purposes of subsection (2). This excludes sales if an allowance or charge is not capable of being made for Parts 3, 5, 6, 9 and 10 (industrial buildings, mineral extraction, research and development, dredging, and assured tenancies).

1979. The inclusion of Part 9 (dredging) in this list may seem odd as sections 567 to 570 do not apply to Part 9. That is because in Part 9 a disposal event does not lead to a disposal value being brought into account. So substituting market value as the disposal value would have no effect.

1980. The scope of this subsection is wider. It prevents an election if, as a result of the sale, any allowances or charges in the Parts listed would no longer be made. This applies whether or not the allowance involved is the subject of the election. For example an election might (but for this section) be made in respect of an industrial building. But if, as a result of the sale, no dredging allowance would fall to be made then the election is prohibited.

1981. *Subsection (4)* is based on section 158(3)(c) of CAA 1990. It is relevant to assured tenancy allowances.

Chapter 6: Final Provisions

Overview

This Chapter deals with definitions and interpretations that apply to the whole Act.

Section 571: Application of Act to parts of assets

1982. This section is based on section 161(7) of CAA 1990. It provides that references to an asset include references to part of an asset (except if the context otherwise applies).

Section 572: References to sale of property and time of sale

1983. This section is based on section 150(4) of CAA 1990. It defines references to "sale of property" and "time of sale".

1984. *Subsection (1)* defines "references to sale of property" to include references to exchange of property.

1985. *Subsections (2)* and *(3)* modify references to sale in subsection (1).

1986. *Subsection (4)* defines the "time" of sale for the purposes of this Act.

Section 573: Transfers treated as sales

1987. This section is based on various sections of CAA 1990. It applies to Parts 3 (industrial buildings), 4 (agricultural buildings) and 10 (assured tenancies) and treats transfers of the relevant interest as sales.

Section 574: Meaning of "control"

1988. This section is based on section 161(2) of CAA 1990. It gives the meaning of "control" for the whole of this Act.

Section 575: Connected persons

1989. This section is based on various sections of CAA 1990. It applies section 839 of ICTA to this Act.

Section 839 of ICTA (Connected persons)

"(1) For the purposes of, and subject to, the provisions of the Tax Acts which apply this section, any question whether a person is connected with another shall be determined in accordance with the following provisions of this section (any provision that one person is connected with another being taken to mean that they are connected with one another).

(2) A person is connected with an individual if that person is the individual's wife or husband, or is a relative, or the wife or husband of a relative, of the individual or of the individual's wife or husband.

(3) A person, in his capacity as trustee of a settlement, is connected with—
 (a) any individual who in relation to the settlement is a settlor,
 (b) any person who is connected with such an individual, and
 (c) any body corporate which is connected with that settlement.

In this subsection "settlement" and "settlor" have the same meaning as in Chapter IA of Part XV (see section 660G(1) and (2)).

(3A) For the purpose of subsection (3) above a body corporate is connected with a settlement if—
 (a) it is a close company (or only not a close company because it is not resident in the United Kingdom) and the participators include the trustees of the settlement; or
 (b) it is controlled (within the meaning of section 840) by a company falling within paragraph (a) above.

(4) Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership, and with the wife or husband or relative of any individual with whom he is in partnership.

(5) A company is connected with another company—

(a) if the same person has control of both, or a person has control of one and persons connected with him, or he and persons connected with him, have control of the other; or

(b) if a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person with whom he is connected.

(6) A company is connected with another person if that person has control of it or if that person and persons connected with him together have control of it.

(7) Any two or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company.

(8) In this section—

"company" includes any body corporate or unincorporated association, but does not include a partnership, and this section shall apply in relation to any unit trust scheme as if the scheme were a company and as if the rights of the unit holder s were shares in the company;

"control" shall be construed in accordance with section 416; and

"relative" means brother, sister, ancestor or lineal descendant.

Section 576: Meaning of "the Inland Revenue" etc.

1990. This section includes a minor change in giving the meaning of two terms used in this Act: "the Inland Revenue" and "the Board of Inland Revenue".

1991. The change is that the term "Inland Revenue" is used in various places in this Act where CAA 1990 refers to an "inspector". This is in keeping with the approach taken in legislation since 1994. But the term "the Board of Inland Revenue" is kept and used if CAA 1990 requires something to be done by the Board (as in sections 554(4) and 563(4)). See *Change 64* in Annex 1.

1992. *Subsection (3)* is based on the definition of "the Board" in section 161(2) of CAA 1990.

Section 577: Other definitions

1993. This section is based in part on section 161 of CAA 1990 but contains material derived from various sources. It provides other minor definitions for the whole Act.

1994. *Subsection (1)* contains some definitions which are new in this Act. These are "property business", "tax year" and "tax year 2001-02".

1995. *Subsection (2)* is based on section 161(9) of CAA 1990. It contains a change because of its application to property businesses. See *Change 62* in Annex 1.

1996. Section 161(3) of CAA 1990 has not been reproduced in this section. Its effect is preserved in another way. See *Note 74* in Annex 2.

1997. *Subsection (5)* introduces Schedule 1 which is in two Parts. Part 1 is a list of abbreviations used. Part 2 is a list of where expressions are defined in the Act. There are some other expressions defined for the purposes of particular Chapters or sections which are not listed in Part 2 of Schedule 1.

Section 578: Consequential amendments

1998. This section gives effect to Schedule 2.

Section 579: Commencement and transitional provisions and savings

1999. This section provides for commencement and gives effect to Schedule 3.

2000. Subsection (1) provides that this Act shall have effect for income tax chargeable periods ending on or after 6 April 2001, and for corporation tax chargeable periods ending on or after 1 April 2001.

2001. This is subject to paragraph 8 of Schedule 3 to this Act. That enables taxpayers to elect to apply the "old" law if something done before 1 or 6 April 2000 (as the case may be) has a different effect in a chargeable period which straddles the commencement date because of changes made by this Act.

Section 580: Repeals

2002. This section gives effect to Schedule 4.

Section 581: Citation

2003. This section allows this Act to be cited as Capital Allowances Act 2001.

Schedule 1: Index of defined expressions

2004. Schedule 1 lists expressions defined in the Act.

Schedule 2: Consequential amendments

Paragraph 1

2005. This paragraph amends section 42(7) of TMA 1970. That provision deals with claims and elections in respect of activities carried on in partnership.

2006. The amendment includes a reference to section 129 (allocation of expenditure on ships to appropriate non-ship pool). This is included because this Act now provides for an election to allocate expenditure on the provision of a ship to the appropriate non-ship pool. See *Change 21* in Annex 1.

2007. Sections 30 and 31 of CAA 1990 deal respectively with the postponement and bringing back into play of first-year and writing-down allowances. The rules for the different kinds of allowance are now dealt with by single provisions. For example, section 131 deals with subsequent claims for both first-year allowances and writing-down allowances that were previously postponed. But under CAA 1990, only claims in respect of writing-down allowances are dealt with in section 42(7) of TMA 1970. To ease the administration for partnerships, this Act ensures that claims in respect of first-year allowances will also be covered by section 42(7). See *Change 65* in Annex 1.

2008. The references to sections 40B and 40D of F(No.2)A 1992 replace the references to section 68(5) and (9) of CAA 1990. These are new and arise from the new sections to be inserted into that Act by paragraph 83 of this Schedule.

2009. The references to sections 1 and 22 to 25 of CAA 1990 are not rewritten in this Act. They relate to claims for allowances and are covered by section 3(3) of this Act. See *Note 1* in Annex 2.

Paragraph 4

2010. This paragraph amends the Table in section 98 of TMA 1970. That provision deals with penalties for taxpayers who fail to provide the Inland Revenue with required information. Column 1 of the Table deals with cases in which information is required following the service of a notice by the Inland Revenue; column 2 deals with information required in other cases.

2011. The references in column 1 to sections 23(4) and 49(4) of CAA 1990 are to be removed and not replaced. Similarly with the references to sections 23(2) and 49(2) in column 2. This is because sections 23 and 49 of CAA 1990 are not being rewritten.

Paragraphs 13 and 14

2012. These paragraphs remove the references to section 29 of CAA 1990 in sections 65A and 70A of ICTA. These sections state that the rules for furnished holiday lettings businesses do not apply to overseas property. In section 17(1) it is clearly stated that such a business cannot be a qualifying activity in respect of overseas property. As a result, the rule does not need to be restated in ICTA.

Paragraphs 16 and 17

2013. These paragraphs relate to section 63(2) and *Changes 12* and*13* in Annex 1.

Paragraphs 22 and 23

2014. These paragraphs amend sections 117 and 118 of ICTA which deal with limited partners. The amendment removes references to sections 141 and 145 of CAA 1990 which have no effect. See *Note 75* in Annex 2.

Paragraph 25

2015. This paragraph amends section 198 of ICTA which deals with deductions from employees' emoluments. The words being removed are to be preserved in the new Act. See section 20(2) and (3).

Paragraph 30

2016. This paragraph is based on section 142 of CAA 1990. It restricts the use of loss relief under sections 380 and 381 of ICTA (income tax losses) in certain circumstances.

2017. The paragraph inserts into ICTA a new section 384A which puts the provision alongside existing similar provisions.

Paragraph 32

There are no longer any allowances that can be given to traders by discharge or repayment. This amendment therefore omits section 393A(5) and (6) of CAA 1990. See *Note 75* in Annex 2.

Paragraph 38

2018. This removes the reference to section 161(5) of CAA 1990. That provision deals with the "taxing of trades". This concept is replaced in this Act by treating allowances as expenses and any balancing charges as income. As a result, the opening words of section 411(10) are no longer needed.

Paragraph 39

2019. This removes sections 434D and 434E of ICTA. These are being rewritten as sections 255 to 257 (part of Chapter 19 of Part 2) and sections 544 and 545 (Chapter 1 of Part 12).

Paragraph 40

2020. This updates a reference to section 306 of Income and Corporation Taxes Act 1970 which should have been revised to read section 28 of CAA 1990 when the capital allowances legislation was last consolidated. It is sufficient to change the reference to Part 2 of the Capital Allowances Act and this should be clearer for users of the legislation.

Paragraph 42(3)

2021. This updates the definition for "regional development grant" in section 495 of ICTA. This removes the references to the Industrial Development Act 1982 and the Industry Act 1972 which have ceased to have any practical relevance.

Paragraph 44

2022. This removes sections 520 to 523 of ICTA which are rewritten by Part 8 of this Act (patent allowances).

Paragraph 45

2023. This paragraph amends the reference to section 152 of CAA 1990. That section deals with successions and partnership changes. The principal parts of these provisions have been rewritten as sections 558 and 559. However, as section 525 of ICTA is only concerned with cases in which there is a (deemed) discontinuance of the relevant activity, the revised reference need only be to section 559.

Paragraph 46

2024. This paragraph removes references to sections 520 to 523 of ICTA. See paragraph 45 above.

Paragraph 47

2025. This removes section 530 of ICTA which is rewritten by Part 7 of this Act (know-how allowances).

Paragraphs 48 to 50

2026. These amendments are made as a result of provisions relating to capital allowances for patents and know-how being moved to the Capital Allowances Act.

Paragraph 51

2027. This paragraph amends section 577 of ICTA. That section deals with certain disallowable expenses incurred in providing business entertainment. The provisions relating to capital allowances are included in section 269 and are therefore no longer necessary in ICTA.

Paragraph 52

2028. This paragraph is based on section 35(2) and (3) and parts of section 36 of CAA 1990. It inserts new sections 578A and 578B in ICTA. These maintain restrictions on car rental costs if a car has a retail price when new in excess of £12,000.

2029. This legislation is related to that which restricts capital allowances in respect of cars costing more than £12,000 (see Chapter 8 of Part 2 of the Act). It was introduced with the capital allowances legislation by FA 1971 and consolidated with it in CAA 1990. However the legislation does not deal with capital expenditure and is better dealt with in ICTA.

2030. *New section 578A(1)* lists the activities that are affected by the restriction.

2031. *New section 578A(2)* provides that these rules do not apply to "qualifying hire cars" or to cars with a retail price of £12,000 or less.

2032. *New section 578A(3)* includes a formula to determine the proportion of rental costs that may be allowed for tax purposes. This proportion effectively provides relief in respect of the first £12,000 of the retail price plus half of the excess. So, for example, a car with a retail price of £24,000 will obtain relief in respect of three quarters of the rental costs.

2033. *New section 578A(4)* deals with rental rebates received. It provides that only a proportion should be taxed as income. This proportion is the same as the proportion that obtained relief under subsection (3).

2034. *New section 578B(1)* to *(3)* defines the terms used in new section 578A.

2035. *New section 578A(4)* provides that the £12,000 threshold may be changed by the Treasury.

Paragraph 61

2036. Section 834(2) of ICTA supplements section 6(4) of ICTA to extend the meaning of "trade" and "profits" in certain parts of ICTA and for the purposes of sections 144 and 145 of CAA 1990. These extended meanings are not needed for this Act.

Paragraph 62

2037. Section 835(8) of ICTA refers to Parts I to VI of CAA 1990. However, in practice, this provision only relates to allowances in respect of special leasing. There is also a similar rule for patents within ICTA itself. As a result, the reference has been replaced to deal with these two specific situations. See *Note 62* in Annex 2.

Paragraph 64

2038. Paragraph 10B(2A) of Schedule 19AC to ICTA modifies section 440 of ICTA by inserting a subsection (4AA). This paragraph substitutes a new text of that subsection (4AA) to take account of the way section 81 of CAA 1990 is rewritten in this Act.

2039. Prior to this substitution subsection (4AA) referred to sections 81 and 83 of CAA 1990:

"(4AA) Section 81 of the 1990 Act (as it has effect by virtue of section 83(2A) of that Act) shall apply in relation to any case in which an asset or part of an asset held by an overseas life insurance company-

(a) ceases to be within the category set out in paragraph (h) of subsection (4) above; and

(b) at the same time comes within another of the categories set out in that subsection.

2040. The text substituted by this paragraph differs in two respects.

2041. First, it omits the words in parentheses which refer to section 83(2A) of CAA 1990. Section 83(2A), in summary, confirmed that capital allowances are restricted to the part of the trade or other activity that is taxable in the UK. It was inserted by FA 2000. The reference in paragraph 10B(2A) of Schedule 19AC (which was also inserted by FA 2000) was then a useful reminder of its effect. In this Act the effect of section 83(2A) of CAA 1990 is preserved. And it applies to all chargeable periods to which this Act applies. There is then no need to remind readers of the point.

2042. Second, the substituted text refers only to section 13 (use for qualifying activity of plant or machinery provided for other purposes). In contrast, the reference in subsection (4AA) provides for section 81 to apply. That includes, in principle, cases falling within section 81(1)(b) of CAA 1990 – see section 14 (use for qualifying activity of plant or machinery which is a gift). This is however of no effect in the context of subsection (4AA).

Paragraphs 75 ***and*** *76*

2043. There are no longer any allowances that can be given to traders by discharge or repayment. This amendment therefore removes such references in The Social Security

Contributions and Benefits Act 1992 and The Social Security Contributions and Benefits (Northern Ireland) Act 1992. See *Note 75* in Annex 2.

Paragraphs 77 and 79

2044. The new section 37(2)(c) of TCGA 1992 and reference to disposal values (rather than "balancing charge") in section 195 of TCGA 1992 are consequential on a change of approach taken in Part 6 of this Act. Where Part VII of CAA 1990 gives, in respect of qualifying expenditure, an allowance and a charge in the same chargeable period, Part 6 of this Act gives a "net allowance". See *Note 57* in Annex 2.

Paragraph 82

2045. This paragraph is based on section 68 of CAA 1990. That is legislation for expenditure on films which may or may not be capital expenditure. It:

- treats the expenditure as revenue expenditure (and does other things); or
- if an election can be and is made, leaves the expenditure to be treated as revenue or capital expenditure in the normal way.

2046. This paragraph puts the provisions with other legislation about films. It includes in the new section 40B of F(No.2)A 1992 a definition of "relevant periods". This is expressed differently from section 68(3) of CAA 1990. The revised wording makes clear what the relevant period is if no accounts of the trade or business concerned are made up for a period. See *Note 76* in Annex 2.

Paragraph 105

2047. This paragraph amends Schedule 33 to the Greater London Authority Act 1999. Subparagraph (3) replaces paragraph 4(9) of that Schedule. At a first glance it appears that the replacement adds a provision preventing writing-down allowances from arising from a qualifying transfer – something that does not appear in the original paragraph. This, however, is not a change as both the original paragraph and its replacement prevent the transfer from giving rise to qualifying expenditure and as a result prevent writing-down allowances from arising. The additional words in the replacement paragraph simply make clearer the preclusion of writing-down allowances.

2048. Similarly with subparagraph (6) which replaces paragraph 10(10) of Schedule 33.

Paragraph 108

2049. This paragraph amends Schedule 22 to FA 2000 (tonnage tax). Most of the amendments are straightforward.

2050. Subparagraph (16) replaces a reference to "section 8(1) to (12) of the Capital Allowances Act" in paragraph 84(2). The new reference (to "Chapter 8 of Part 3") appears to go wider than the original version. However, paragraph 84 only applies when the company disposes of the relevant interest in an industrial building or structure. As a result, there is no change by now referring to the whole of Chapter 8. Similarly, there is no need to refer to section 351 which deals with additional VAT rebates.

Schedule 3: Transitionals and savings

2051. Provisions of only transitional effect are brought together in this Schedule. This is different from the approach taken in CAA 1990. It allows this Act to meet comments from those who responded in consultation that:

- the effect of provisions in the existing legislation should be maintained in the Act even if there is very little chance of their having practical effect; and

- shorter and clearer legislation in the main body of the Act helps readers who want to know the treatment of expenditure in periods covered by the Act.

2052. There is nothing in this Schedule to reflect section 18(11) of CAA 1990. See *Note 78* in Annex 2.

2053. Sections 39(2)(a) and (8)(a), 40(4)(a) and (b)(ii), 45, 47 and 49 of CAA 1990 ("the old expenditure provisions") are not reproduced in this Schedule. See *Note 77* in Annex 2.

Paragraphs 1 to 7

2054. Paragraph 2 is included to ensure that provisions in the Act which change the law are not subject to the general proposition about continuity.

Paragraph 8

2055. This paragraph allows anyone affected by the minor changes in the law in this Act to elect that those changes do not apply for a chargeable period which started before 1 April 2001 (for corporation tax) or 6 April 2001 (for income tax) and ends after. This allows the Act to be applied as soon as practicable (which is what consultation showed was generally wanted) without imposing changes retrospectively.

2056. Paragraph 8(5) provides two meanings of "the relevant chargeable period". In general it is a chargeable period which straddles 1 or 6 April. But there is a special rule for contributions. This is because a contribution might, in principle at least, be made in a straddling chargeable period (or an earlier chargeable period) to expenditure which is not incurred until a chargeable period which starts after 1 or 6 April.

Paragraph 24

2057. This paragraph ensures that the further registration requirement for the deferment rules (in section 154) does not apply in respect of ships first brought into use before 21 April 1994.

Paragraph 46 to 51

2058. These paragraphs maintain entitlement to first-year allowances for additional VAT liabilities in respect of plant or machinery within the VAT capital goods scheme. This arises broadly if:

- there was expenditure on computers which qualified for first-year allowances in the period 1 November 1992 to 31 October 1993 or 2 July 1997 to 1 July 1998;
- the expenditure was incurred by a partially-exempt business; and
- the proportion of exempt business changes.

2059. This affects a tiny minority of taxpayers. They will all have had to claim the first-year allowances in accordance with the legislation for the periods in question. The possibility of additional VAT liabilities only arises for up to ten years after the expenditure. So the legislation is both transitory and of only very limited interest.

2060. The same approach is taken to initial allowances for contracts entered into between October 1992 and November 1993 for buildings in enterprise zones. See paragraph 75.

Paragraph 55

2061. This paragraph is based on section 82 of CAA 1990. It provides for expenditure which was:

- incurred before 6 April 1976; and

- was not eligible expenditure within section 39 of FA 1976

to be unaffected by the Act.

2062. The type of expenditure that is involved relates back to before the introduction of pooling in FA 1971. Expenditure could not be pooled under the FA 1971 provisions if it was incurred before 27 October 1970. In 1976, remaining expenditure which was still not pooled could be pooled but an exception was made for some types of expenditure, broadly those things that would be in single asset pools.

2063. In CAA 1990 the position was preserved by section 82 of CAA 1990. This disapplied CAA 1990 and all its repeals for this expenditure so that it continued to be treated as before, without being pooled.

2064. It is impossible to say whether any of these pools are still in existence and it is equally impossible to say that there are none. This paragraph therefore preserves the position.

Paragraph 88

2065. This is based on section 119 of CAA 1990 and deals with the transition from MOWA in 1986. Its principal effect now is to allow recapture under Part 5 of excessive relief on expenditure incurred before 1 April 1986 even where some or all of that relief was given under MOWA.

Paragraph 94

2066. This paragraph is based on section 522(2) and (7) of ICTA and section 146(3) of CAA 1990. It provides writing-down allowances for expenditure on the purchase of patent rights incurred before 1 April 1986.

2067. *Subparagraph (2)* preserves the effect of section 161(3) of CAA 1990. See *Note 74* in Annex 2.

Paragraph 98

2068. This paragraph is based on section 523(4) of ICTA. It provides a reduced writing-down allowance on pre-1 April 1986 expenditure.

2069. *Subparagraph (3)* is new. It provides that the reduced writing-down allowance is proportionately increased or reduced if the chargeable period for which it is given is more or less than a year. See *Change 66* in Annex 1.

Schedule 4: Repeals

2070. This Schedule makes repeals.

COMMENCEMENT

2071. This Act came into effect on Royal Assent. Section 579 provides for it to apply

- for income tax purposes for chargeable periods ending on or after 6 April 2001; and
- for corporation tax purposes for chargeable periods ending on or after 1 April.

2072. The different dates reflect the fact that the income tax year starts on 6 April and the financial year on 1 April.

HANSARD REFERENCES

The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

Stage	***Date***	***Hansard reference***
House of Commons		
Introduction	9 January 2001	Vol 360 Col 1079
Second Reading	15 January 2001	Vol 361 Cols 101–144
Joint Committee on Tax Simplification Bills – First Report	31 January 2001	HC 175
	1 February 2001	HL Paper 24
Third Reading	13 February 2001	Vol 363 Cols 244–286
House of Lords		
Introduction	14 February 2001	Vol 622 Col 247
Second reading	26 February 2001	Vol 622 Cols 969–987
Third reading	6 March 2001	Vol 623 Col 133

Royal Assent – 22 March 2001	House of Lords Hansard Vol 623 Col 1529
	House of Commons Hansard Vol 365 Col 497