

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Plant and machinery allowances

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.

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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.

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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.

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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

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- *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)* disappplies 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 disappplies 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.