

Essential Guide to Claiming Capital Allowances for Property Expenditure

In this article Philip O'Connor aims to demystify this complex area of tax law.

Capital allowances claims for property expenditure range from the simple to the extremely complex. Where claims are carefully prepared, they can provide a low-risk and tax compliant contribution towards significantly reducing the claimant's tax liability.

What are capital allowances?

Capital expenditure is not tax deductible. However, tax relief is available through the capital allowances regime for the depreciation of certain capital assets used in the course of a business.

Whether a business incurs capital expenditure on occupied business property or on property investments, capital allowances are an issue that they will need to address, due to the considerable savings they can provide.

In the past, capital allowances and other property tax incentive schemes have been used by government as a tool for incentivising investment in certain geographic areas and specific building types. Following the abolition of various generous temporary property tax incentive schemes in recent years, traditional forms of capital allowances which have always been available are now more important than ever. These include:

- Wear and Tear Allowances (including Accelerated Capital Allowances)
- Industrial Building Allowances

This article focuses on Wear and Tear Allowances (WTAs) which are the most commonly available form of capital allowance.

Rates of relief and typical claim values

Industrial Building Allowances are available at 4% per annum over a 25-year period (accelerated rates are available for certain building types).

Wear and Tear Allowances are claimed at 12.5% per annum over an eight-year period.

Accelerated Capital Allowances provide 100% tax relief in the first year and are available to companies and unincorporated businesses for expenditure on eligible energy efficient equipment. Eligible equipment can be found on the Triple E Products Register, which is operated by the SEAI in conjunction with Revenue. Leased equipment does not qualify.

Opportunities for making WTA claims are usually easy to identify and include the following situations:

1. Claims for chattels expenditure, i.e. loose plant and machinery.
2. Claims for plant and machinery fixtures attached to a property, which can be made in the following situations:
 - Capital projects including property developments, fit-outs, refurbishments, extensions and alterations.
 - Purchases of existing property.

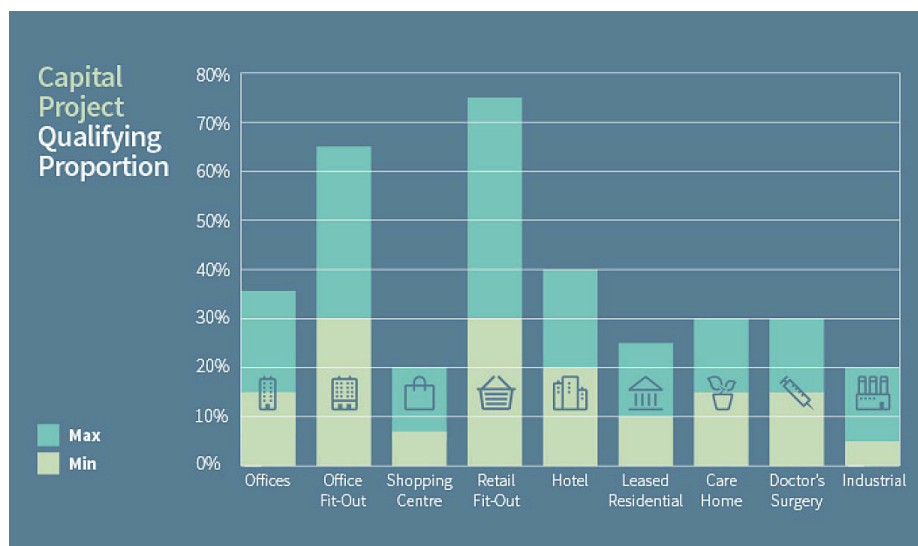
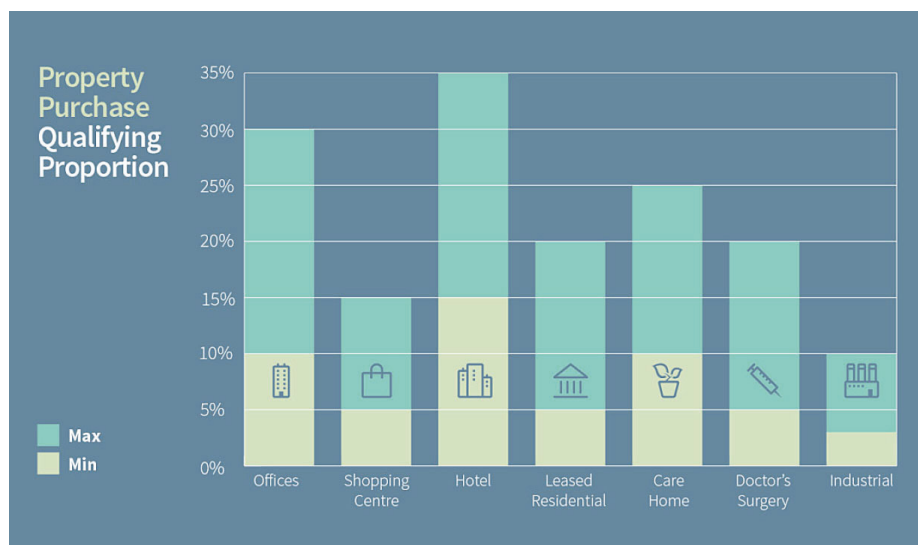
The following graphs provide indicative qualifying amounts for fixtures claims on both capital projects and property acquisitions.



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The above excludes any claims for chattels, which would provide additional tax relief.

What qualifies for wear and tear allowances?

WTAs are available for capital expenditure incurred only on **plant and machinery**. What constitutes a **machine** is easy to define but there is no definition of **plant**. Certain items have been held to be plant in specific circumstances in various legal cases in Ireland and other common law countries, and some of these items are listed here:

- Heating, ventilation and air-conditioning
- Lifts, escalators and moving walkways
- Sanitary fittings
- Security installations
- Furniture
- Catering equipment

Under case law, numerous other assets have been held to be plant in specific situations, however whether an item qualifies typically depends on how it is used in the course of each taxpayer's business. Therefore, an item might qualify in one situation but not in another. In the case of *IRC v Scottish & Newcastle Breweries* [1982] the following judgement commentary summed this up well:

"Whether an item qualifies as plant should be determined not only by reference to the nature of the trade but to the particular operations and methods of the taxpayer in the pursuance of his particular business. There can, be no 'standard pattern' of permissible plant in respect of each industry, trade or profession."

We can use fixed lighting as an example to illustrate this point, which based on case law precedents, is usually not plant. It can sometimes qualify however in specific

circumstances, where it is used in the course of the trade. This could be argued for some leisure and retail trades, however the same lighting found in an office property will almost always be non-qualifying. In order to determine whether an item such as lighting qualifies in a particular situation, it is required to reference the relevant case law, which in the case of lighting includes *Lyons & Co v AG* [1944], *Cole Bros v Phillips* [1982], *Wimpy v Warland* [1989], *IRC v Newcastle & Scottish Breweries* [1982], *JD Wetherspoon v HMRC* [2012] and others.

It is interesting to note that since 2008 in the UK, the same restrictive rules no longer apply and lighting now qualifies in all situations due to the introduction of the **Integral Features** legislation.

In order to determine whether an asset may qualify as plant in a particular circumstance, reference should be made to the volume of case law relevant to that asset. There is an enormous amount of case law addressing different assets and different situations which can provide guidance.

Case law has also provided a number of "tests" which can be applied in order to decide whether an asset may qualify in a particular circumstance.

How do I quantify the qualifying expenditure?

Claims for chattels

With a good knowledge of the legislation and relevant case law, claims for chattels can be relatively straightforward. This involves analysing fixed asset ledgers and backup invoices, and identifying qualifying expenditure. If entitlement to claim exists, the qualifying expenditure should then be claimed for the period in which the expenditure was incurred, or when the asset was put into use if this was later.

Claims for plant and machinery fixtures

Whilst claims for chattels are usually straightforward, fixtures claims on capital projects and property acquisitions require more thought and investigation, as there are more complex entitlement issues to be considered and the qualifying costs are not often easily identifiable. For example, in capital projects where lump sum costs appear in a fixed asset ledger for a property

acquisition or for building works, analysis is required in order to extract the qualifying expenditure.

Such qualifying expenditure includes not only the cost of the asset itself but also costs incidental to installing the asset. Using the example of lighting again, the qualifying cost could also be argued to include not just the cost of the lighting unit, but also the associated wiring, labour costs, etc. as well as a proportion of relevant professional fees, and other relevant "soft costs".

Although considerable analysis is usually required, it is important to ensure that valuable fixtures claims are not ignored as they typically amount to over 20% of the purchase or capital project cost.

The main steps involved in making claims for capital projects and property purchases are set out below.

Capital projects

(a) Due diligence – establish a legal basis for claiming based on legislation and case law (see due diligence section below).

(b) Project team briefing – liaise with the project team to ensure that sufficient information is obtained to analyse the expenditure in detail. If there is entitlement to claim accelerated capital allowances (ACAs), request the information required to quantify and maximise this relief. Collate construction cost information, specifications, drawings, equipment registers, etc.

(c) Capital allowances survey – ensure that notes and photographic records are taken of all qualifying assets.

(d) Claim preparation:

- Analyse information and categorise into qualifying and non-qualifying expenditure.

- Undertake cost assessments where required on lump sums to extract qualifying expenditure. Cost assess qualifying assets identified on survey, but not sufficiently detailed in cost breakdowns.

- Identify and analyse expenditure incurred in addition to the building contract and apportion "soft costs" to justifiably maximise the claim.

- Ensure that the costs analysed reconcile with the business accounts.

(e) Submit claim to Revenue – claim the allowances based on the date of expenditure of the various assets, or the date of first use if this is later. Detailed records should be kept for to justify the claim in the event of a Revenue investigation.



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Purchase of an existing property

- (a) Due diligence – as above, in addition to reviewing the relevant purchase information and researching the history of the property, in order to establish a reasonable basis for claiming.
- (b) Capital allowances survey – take detailed notes and compile photographic records. Qualifying assets can be identified and recorded, and used to build up a specification for the property.
- (c) Building and plant and machinery reconstruction cost estimate – create a specification for the property based on information compiled. Undertake a reconstruction cost estimate at the date of purchase.
- (d) Analyse and quantify the qualifying plant and machinery.
- (e) Site valuation – undertake a bare site valuation at the date of purchase.
- (f) Just Apportionment" calculation – apportion the values of land, building and plant and machinery to the property purchase price paid. This must be done in accordance with s311 TCA 1997 and Revenue Precedent IT963250, which requires a professional valuation be undertaken.
- (g) Submit claim to Revenue as above.

What due diligence should I undertake?

Once it is apparent that qualifying expenditure is present, the first step should be to establish a legal entitlement to claim, based on the applicable legislation. Many provisions of TCA 1997 apply and the basic conditions are outlined in s.284 which sets out the following conditions:

- A trade or profession must be carried on
- Capital expenditure must be incurred on the provision of plant and machinery
- Plant and machinery must be used wholly and exclusively for the purposes of the trade
- The plant and machinery must belong to the claimant
- The plant and machinery must be in use for the purposes of the trade

For lessors of plant and machinery, which includes most landlords of leased property, the following additional conditions of Section 298 apply:

- The burden of wear and tear must fall directly on the lessor of the plant and machinery
- A claim can be made within 24 months after the end of the chargeable period

With regard to modern commercial lease agreements, the *burden of wear and tear* causes much confusion amongst potential claimants; however, the term is not quite as restrictive as its initial reading in legislation implies.

Case law such as *Lupton v Cadogan Gardens* [1971], *MacSaga Investment v Lupton* [1967] and other cases have helped to interpret this term, however like the definition of plant, there is no set pattern to determine who bears the burden of wear and tear and each must be assessed on its own merits.

In all situations, case law should be referred to in conjunction with the lease agreement and other relevant documents to determine whether the landlord (as the lessor) or the tenant (as the lessee) suffers the burden of wear and tear.

Depending on the situation, additional conditions set out in other sections of legislation will also apply when determining whether entitlement to claim exists.

The importance of retaining claim information

Generous time limits are available to Revenue for investigating the tax returns of tax payers and because a Revenue investigation into a claim could occur many years after a transaction, it is important that sufficient backup information and records are retained at the time of claiming.

It is notoriously difficult to obtain detailed information and records for construction projects and property acquisitions years after the event and this approach can help to avoid the negative consequences of such investigations, if they occur.

Revenue have four years from the end of the period in which the tax return is filed in which to investigate, however where there are reasonable grounds to believe there is fraud or neglect, the time period is open ended.

Revenue have not clarified whether this time period relates to when the claim is first made or whether it is from the last year of claiming. If the latter applies, the enquiry period could be twelve years after the period in which the claim was first made and even longer since the expenditure was incurred.

