

CHAPTER 10

CAPITAL ALLOWANCES - DEFINITIONS

Statutory references in this chapter are to CAA 2001 unless otherwise stated.

10.1 Introduction

When a trader incurs expenditure of a capital nature, such costs are not deductible from trading profits because the expenditure will have an "enduring benefit" for the trade.

No deduction is usually available for the depreciation of capital assets.

Instead, where businesses employ **capital assets for use in their business** (for example machinery, motor vehicles etc) they receive a measure of relief in the form of "capital allowances". Capital allowances compensate a business for the **fall in value of capital assets** used in the trade. Essentially capital allowances are a form of **tax-approved depreciation**.

Relief is given by treating the capital allowances as an **expense to be deducted when arriving at the taxable trading profits** for the accounting period.

Year ended 31 December 2010:

| | |
|---|------------|
| | £ |
| Tax adjusted profit before capital allowances | X |
| Less: capital allowances | <u>(X)</u> |
| Taxable trading profit | <u>X</u> |

Assuming that the trader has a year-end of (say) 31 December 2010, capital allowances are given for the accounting period to arrive at the taxable profit for the year ended 31 December 2010. These profits will then be **taxed in 2010/11 under the current year basis**.

10.2 Types of capital allowances

Capital allowances are given at specific rates as laid down in the Capital Allowances Act 2001. The rates of relief depend on:

- 1) the **type** of capital expenditure incurred; and
- 2) the **date** the costs are incurred.

Capital allowances are given when a business incurs expenditure on the following:

- 1) Plant and machinery;
- 2) Industrial buildings; and
- 3) Agricultural buildings.

Industrial buildings allowances (IBAs) and agricultural buildings allowances (ABAs) are not in your syllabus.

Here we will start with plant and machinery allowances. Finance Act 2008 introduced significant changes to the Capital Allowances regime. You are only examinable on this new regime which is effective from 6 April 2008.

10.3 Definition of "plant and machinery"

Before we look at how we calculate capital allowances, we first need to look at the definition of "plant and machinery".

The definition of plant and machinery is found in the **Capital Allowances Act 2001 (CAA 2001)**. There is also a **significant body of case law** discussing what is and what is not "plant".

[CAA 2001, s. 21-33A](#)

Yarmouth v France (1887) defines "plant" as:

"... whatever apparatus is used by a businessman for carrying on his business - not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or moveable, live or dead, which he keeps for permanent employment in the business."

HMRC practice is to treat an asset that has an expected life of **two years or more** to be for "permanent employment" and to therefore be sufficiently durable to qualify as plant. If an asset has a useful life of **less than two years**, the costs will probably be directly **deductible as allowable business expenses**.

The quotation also made it clear that the **business premises are not plant** because they are not "goods or chattels" employed in carrying on the business. Rather, they are the **place or setting in which the business is conducted**.

The test of whether an item is apparatus used in carrying on a business is the **"functionality test"**.

If the asset **has a function**, it will be **plant** and capital allowances can be claimed. However, if expenditure has been incurred by the trader on **part of the setting** within which he runs his business, it will **not be plant** and no allowances can be claimed. This was established in the case of *J Lyons & Co v Attorney General* and has been revisited many times by the Courts in deciding what is or is not "plant".

Over the years, hundreds of cases have gone through the Courts to determine whether expenditure does or does not qualify as "plant" for the purposes of calculating capital allowances.

In 2001, HMRC consolidated the capital allowances legislation in a new Capital Allowances Act (CAA 2001). Within CAA 2001, HMRC took the opportunity to give **statutory authority to some of the precedents previously established by case law**. Therefore, for the first time, CAA 2001 attempted to define more precisely what is meant by plant and to differentiate between "qualifying" and "non-qualifying" expenditure.

The relevant legislation can be found at s.21 to s.38 CAA 2001.

10.4 Buildings - Section 21 CAA 2001

[CAA 2001, s. 21](#)

Buildings are part of the "setting" in which the business is carried on and will **not** qualify as "plant".

List A in s.21 provides further clarification as to items included within the term "building", specifically detailing the following:

- 1) Walls, floors, ceilings, doors, gates, shutters, windows, stairs.
- 2) Mains services and systems for water, electricity and gas.
- 3) Waste disposal systems.
- 4) Sewerage and drainage systems.
- 5) Shafts or other similar structures.
- 6) Fire safety systems.

Therefore expenditure on these particular items (unless later overwritten by List C in s.23), would be **regarded as expenditure on "buildings" and therefore would not qualify as "plant"**.

10.5 Structures and Land - Section 22 CAA 2001

[CAA 2001, s. 22](#)

Under s.22 **plant and machinery does not include expenditure on the following:**

- a) The provision of a structure or other asset **in List B**; or
- b) Any works involving the **alteration of land**.

List B contains the following:

- 1) Tunnel, bridge, viaduct etc.
- 2) Pavement, road, car park.
- 3) Canal or basin.
- 4) Dam, reservoirs etc.
- 5) Docks, harbours, wharfs.
- 6) Dykes and sea walls.

Therefore expenditure on these particular items (unless later overwritten by List C in s.23), would **not qualify as "plant"**.

10.6 Override - Section 23 CAA 2001

[CAA 2001, s. 23](#)

S.23 tells us that that s.21 and s.22 **do not apply to the following:**

- a) Thermal insulation of buildings.
- b) Safety at designated sports grounds.
- c) Safety at regulated stands at sports grounds.
- d) Safety at other sports grounds.
- e) Personal security.
- f) Integral features.
- g) Software and rights to software.
- h) "List C" items.

Therefore expenditure on any of the items above will be treated as expenditure on "plant" and **will qualify** for capital allowances.

List C is a long list of specific items, most of which have been derived from case law. Therefore we no longer need to refer to much case law as case precedents have now been incorporated into the Capital Allowances Act. The new legislation is very comprehensive and is a great help in determining whether a particular item is plant or not.

List C comprises 33 items. Here are some of the more common ones you may come across in practice:

| <u>Item</u> | <u>Description</u> |
|-------------|--------------------|
|-------------|--------------------|

- | | |
|----|---|
| 13 | "Partition walls where moveable and intended to be moved in the course of the qualifying activity". |
|----|---|

Walls are part of the building and do not qualify as plant.

However in the case of *Jarrold v John Good & Sons*, the Court found that moveable partitions were "apparatus with which the company carried on its business" and hence qualified as plant. This decision has now been incorporated into s.23.

- | | |
|----|---|
| 14 | "Decorative assets provided for the enjoyment of the public in hotel, restaurants or similar trades". |
|----|---|

In *CIR v Scottish & Newcastle Breweries Ltd*, the company spent money on decorative items such as wall plaques, tapestries, murals, prints and sculptures within their pubs and restaurants. It claimed plant & machinery allowances.

The Court agreed with the company and allowed capital allowances to be claimed on the grounds that the expenditure went to create "atmosphere or ambience" and this was an important function of the company's particular trade. This decision has again been incorporated into s.23.

16 "Swimming pools" (including diving boards, slides etc).

In *Cooke v Beach Station Caravans Ltd*, a company operated a caravan park and claimed capital allowances on the construction costs of two swimming pools. HMRC denied the claim on the basis that the swimming pools were part of the setting. However the Court found in favour of the taxpayer and said that the pools were "part of the means whereby the trade is carried on, and not merely the place in which it is carried on". Swimming pools have now been added as "plant" in List C.

22 "The alteration of land for the purposes only of installing plant and machinery".

This means that if (say) a new floor has to be laid or strengthened in order to house some plant and machinery, the costs of laying the floor will qualify for capital allowances.

This is by no means a definitive list and only covers a handful of the types of expenditure listed in List C.

10.7 Plant & machinery - other qualifying expenditure

Expenditure on the following will also be "plant & machinery" qualifying for capital allowances:

- Altering a building for the purposes of installing plant & machinery; [CAA 2001, s.25](#)
- Demolition costs (e.g. costs of removing / demolishing plant & machinery); [CAA 2001, s.26](#)
- Thermal insulation of buildings. [CAA 2001, s. 28](#)

10.8 Plant and machinery used for business entertainment

[CAA 2001, s. 269](#)

Capital allowances are **not given on plant and machinery used for business entertainment**. "Hospitality of any kind" counts as business entertainment.

Plant and machinery provided by a business for its **employees and directors does not count as provided for business entertainment**. Capital allowances will therefore be available in this instance.

10.9 Finance Act 2008 changes in the definition of “plant”

[CAA 2001, s. 33A](#)

FA 2008 has introduced rules regarding “integral features”. Where an item is classified as an “integral feature” to a building, from 6 April 2008 the expense **will qualify for plant and machinery allowances**. “Integral features” include:

- Lifts;
- Escalators;
- Moving walkways;
- Air-conditioning systems;
- Hot & cold water systems;
- Electric lighting and power systems.

We will look at these rules in more detail in a later chapter.

Example 1

Which of the following types of expenditure qualifies as plant?

- a) Decorative tapestries in a hotel
- b) Ship used as a floating restaurant
- c) Advertising hoardings
- d) Suspended ceiling over a stairwell
- e) Suspended ceiling over eating area
- f) "Cold-room" in a restaurant kitchen to keep food cool before cooking
- g) Shutters on shop windows to prevent break-ins

Answer 1

| | Plant? |
|---|--------|
| a) Decorative tapestries in a hotel | ✓ |
| b) Ship used as a floating restaurant | X |
| c) Advertising hoardings | ✓ |
| d) Suspended ceiling over a stairwell | X |
| e) Suspended ceiling over eating area | ✓ |
| f) "Cold-room" in a restaurant kitchen to keep food cool before cooking | ✓ |
| h) Shutters on shop windows to prevent break-ins | X |

- a) Decorative tapestries in a hotel are regarded as plant. In List C item 14, decorative assets provided for the enjoyment of the public in a hotel, restaurant or similar trade will be treated as plant. This was established in the case of *CIR v Scottish & Newcastle Breweries Ltd* where tapestries and murals fitted to the walls of pubs and hotels created an "ambience and atmosphere" with which to attract customers. Therefore such expenditure had a function rather than being part of the setting.
- b) A ship used as a floating restaurant was not regarded as having a function, it was actually the setting in which the trade was carried on (*Benson v Yard Arm Club Limited (1979)*).
- c) Advertising hoardings are specifically within List C, item number 15. Therefore they qualify as plant.
- d) A suspended ceiling over a stairwell is not regarded as plant. It does not fulfil a function, but instead is merely part of the setting. *Hampton v Fortes Autogrill Ltd (1980)*.
- e) A suspended ceiling over an eating area however, could be regarded as plant as it fulfils a function in the trade creating a general atmosphere. Exposed wiring over an eating area is not attractive for customers!
- f) Cold-stores can be found at List C, item number 18. Therefore they qualify as plant.
- g) Shutters are part of a building under List A Item 1. They will not qualify as plant.