These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 26Schedule 4: Capital Allowance Buying

Summary

1. Section 26 and Schedule 4 provide for the introduction of legislation to prevent tax avoidance through the transfer of an entitlement to benefit from capital allowances on plant and machinery used for the purpose of a trade, where the tax written down value of the plant and machinery exceeds its balance sheet value. The legislation has effect from 21 July 2009. Transfers of an entitlement to postponed allowances on ships are included within the scope of these rules but only with effect from 9 December 2009.

Details of the Schedule

2. Paragraph 2 introduces a new Chapter 16A into Part 2 of the Capital Allowances Act 2001 (CAA) consisting of new sections 212A to 212S.

Introduction

3. New section 212A gives the scope of the Chapter explaining that the Chapter restricts the ways in which a plant and machinery allowance may be given effect where there has been a "qualifying change" in relation to a company (C).

4. New section 212B explains that the Chapter applies only where C carries on a trade (alone or in partnership (P) with another person or persons). It sets three further requirements and signposts the relevant sections in new Chapter 16A in relation to each requirement.

Qualifying Change

5. New section 212C provides that where one or more of the four conditions A to D are met, then there is a qualifying change in relation to C.

6. Subsection (2)(a) provides that condition A is met where there is (in broad terms) a change of ownership of C (defined in this legislation as a change in one or more principal companies (as defined in new section 212E) on the relevant day. This includes the creation of a consortium company.

7. For example, condition A is met in the following scenarios:

- C is a wholly owned member of the Y Group and on the relevant day C is sold to the X Group;
- C is a consortium company equally owned by the Y Group and the X Group. On the relevant day Y Group sells its whole interest in C to the X Group (or another Group, the Z Group). Condition A is met as, at the end of the relevant day, Y Group is no longer a principal company of C.

8. Subsection (2)(b) provides that condition A is also met where C is not owned by another company or companies at the start of the relevant day, but is owned by another company or companies at the end of that day.

9. For example, C is owned by the Jones family. On the relevant day the Jones family sell their shares to the X group and condition A is met.

10. As with the majority of the legislation, new section 212C has effect from 21 July 2009, but subsection (2)(b) only has effect where the relevant day is on or after 9 December 2009.

11. Subsection (3) provides that condition B is met where a principal company of C is a consortium principal company (CPC) and CPC's ownership proportion of C is greater at the end of the relevant day than it was at the beginning of that day.

12. For example, C is a consortium company owned equally by the A and X Groups. The A group sells 30 per cent of its 50 per cent share-holding (that is, a 15 per cent share holding in C) to the X group. Condition B is met because the X Group's ownership proportion has increased from 50 per cent to 65 per cent.

13. Subsection (4) provides that condition C is met where C ceases to carry on the whole or part of the relevant trade and the trade (or part of it) begins to be carried on in partnership by two or more companies in circumstances where Chapter 1 of Part 22 of the Corporation Tax Act (CTA) 2010 applies (previously section 343 of the Income and Corporation Taxes Act 1988 (ICTA)). For Chapter 1, and therefore condition C to apply, C cannot be a member of the partnership.

14. Subsection (5) provides that condition D is met where at the beginning of the relevant day the relevant trade is carried on by C in partnership and C's relevant percentage share in the relevant trade at the end of the day is less than at the beginning of the day (or is nil).

15. For example, condition D is met in the following scenarios:

    - a partnership P carries on a trade of widget manufacturer and the partners are C, X Ltd, and W Ltd. C's percentage share at the start of the relevant day is 70 per cent and at the end of that day it is 30 per cent;

    - P carries on a trade of widget manufacturer and the partners in the trade are C, X Ltd, and W Ltd. C's percentage share at the start of the day is 70 per cent and C leaves the partnership so at the end of the day its percentage share is nil.

16. New section 212D is a guide to the sections explaining the terms used in new section 212C.

17. New section 212E explains the rules for deciding if any particular company is a principal company of C and if that principal company is a consortium principal company of C. New sections 212E to 212I are based on similar provisions in Chapters 3, 4 and 5 of Part 9 of CTA 2010 (Sales of lessors).

18. Subsections (1) to (3) provide the detail for determining the principal company of C. The definitions describe a series of relationships traced upward from C until this chain of relationships can go no further because the company at the top of the chain is not a 75 per cent subsidiary of another company.

19. Subsections (4) to (7) provides the detail for determining a consortium principal company of C where C is owned by a consortium or C is a qualifying 75 per cent subsidiary of a company owned by a consortium. As with subsections (1) to (3) the definitions describe a series of relationships but the chain of relationships also includes the situation where C is a qualifying 75 per cent subsidiary of a company owned by a consortium. The chain of relationships also ends when the company at the top of the chain is not a 75 per cent subsidiary of another company.

20. New section 212F defines when a company is owned by a consortium and who the consortium members are for the purposes of new Chapter 16A. It explains the company cannot be a 75 per cent subsidiary of another company and that at least 75 per cent of the company's ordinary share capital must be owned by other companies and those other companies must each own 5 per cent or more of the ordinary share capital.

21. For example, C is a company owned by a consortium in the following scenarios:

    - C's ordinary share capital is owned equally by Y Ltd, X Ltd, W Ltd and Q Ltd. The consortium members are Y Ltd, X Ltd, W Ltd and Q Ltd;
    - C's ordinary share capital is owned as follows: Y Ltd - 25 per cent, X Ltd - 4 per cent, W Ltd - 55 per cent and Q (an individual) - 16 per cent. C is a company owned by a consortium but the consortium members are only Y Ltd, and W Ltd. X Ltd only holds 4 per cent of the ordinary share capital and Q is not a company.

22. New section 212G provides the definition of qualifying 75 per cent subsidiaries. The section gives three conditions, and states that a company is a qualifying 75 per cent subsidiary if Condition 3 is and either Condition 1 or 2 is met. The definitions use the same approach as is used for determining whether companies are in the same group for group relief purposes, but with a modification so that companies without share capital, such as companies limited by guarantee, can be treated as subsidiaries by extending the application of Chapter 6 of Part 5 of CTA 2010 to treat members as if they were equity holders and then applying the tests in Chapter 6.

23. New section 212H provides the rules for establishing the ownership proportion of a consortium principal company for the purposes of Condition B in new section 212C. As for the definition of 75 per cent subsidiaries in new section 212G, provision is made for companies without share capital.

24. New section 212I provides the rules for establishing C's "relevant percentage share" in a partnership. The relevant percentage share is established on a "just and reasonable" basis but particular regard must be had to the matters that would be taken into account in determining a partner's share of the profits or losses of a trade carried on by a firm for the purpose of section 1262 of CTA 2009. This means that normally the profit sharing arrangements of the firm for the particular period will be followed but there may be instances where circumstances are such that to follow the profit sharing arrangements in force for the period would not be just and reasonable.

Relevant excess of allowances

25. New section 212J gives the calculation for establishing whether or not C or P has a relevant excess of allowances in relation to the relevant trade and provides that certain plant and machinery is to be excluded from the calculation.

26. Subsection (1) gives the formula that governs the calculation and provides that C or P has a relevant excess of allowances if the RTWDV (relevant tax written down value) is more than the BSV (balance sheet value).

27. Subsection (4) explains when plant and machinery is "excluded plant and machinery". The subsection excludes two types of assets. The first type is plant and machinery that is owned by C (or P) but is prohibited from qualifying for allowances because the plant and machinery is leased out under a long funding lease and section 34A of CAA prohibits the expenditure from being qualifying expenditure. The second type is plant and machinery that is owned by C (or P) but is prohibited from qualifying for allowances because the plant and machinery is the subject of a hire purchase contract where the person entitled to the benefit of the contract is deemed to be the owner and no other person can be by virtue of section 67 of CAA.

28. New section 212K provides that RTWDV is the "relevant tax written-down value" and explains how it is to be found. In broad terms the section works by totalling two amounts, the first of which is based on the amounts that are actually in the capital

allowances pools but adjusted to include expenditure that has yet to be allocated to a pool and ignoring any disposals on the relevant day. The second amount is the amount of any allowances postponed because a notice has been given under section 130 of CAA.

29. Subsection (2) defines "amount 1" in relation to the three types of plant and machinery pools: single asset pools, class pools and the main pool. The subsection looks to the amount of unrelieved expenditure that is available to be carried forward from all pools (that is after the application of section 56 of CAA) from the "old period".

30. Subsection (3) defines "amount 2" and identifies any first-year or writing-down allowance that has been postponed because a notice has been given under section 130 of CAA, by the person entitled to the first-year or writing-down allowance, in relation to qualifying expenditure incurred on the provision of a ship and not subsequently claimed by the end of the old period. Amount 2 is only included in RTWDV where the relevant day is on or after 9 December 2009.

31. Subsection (4) provides that the amount of unrelieved qualifying expenditure contained in a pool is to be calculated on the basis of three assumptions.

32. Subsection (4)(a) sets out the first assumption which is that any qualifying expenditure that could have been allocated to the pool has been allocated to the pool by the end of the old period. Normally a person can add qualifying expenditure to a pool at any time provided the person still owns the asset at some point in the particular chargeable period in which the person wants to add the qualifying expenditure to a pool. The rule prevents any expenditure being added to any pool after the relevant day as it has already been treated as added on the relevant day.

33. Subsection (4)(b) sets out the second assumption which overrides the normal rule in section 58(5) of CAA and allocates the balance of any first-year qualifying expenditure incurred in the old period to a pool in the old period at the end of the old period.

34. Subsection (4)(c) sets out the third assumption which is that any transaction taking place on the relevant day that has the effect of reducing the amount of unrelieved qualifying expenditure in a pool had not taken place. Where this rule applies new section 212S will also be in point in relation to any transfers of plant and machinery on the relevant day and any person's ability to claim an allowance in respect of it subsequently.

35. Subsection (5) ensures that where condition C is met, i.e. C ceases to carry on the relevant trade or part of the relevant trade and the relevant trade begins to be carried on in partnership by two or more companies, then for the purposes of calculating the amount of unrelieved qualifying expenditure in any pool and the amount of postponed allowances you look at the position in C as it would have been if there had not been a qualifying change.

36. Subsection (6) prevents circularity by identifying which period is the "old period" for the purposes of the section.

37. Subsection (7) explains that the plant and machinery identified by subsections (2) and (3) is referred to as "the relevant plant and machinery" in new sections 212L to S.

38. New section 212L provides that the term BSV, used in section 212J, is the balance sheet value of "the relevant plant and machinery" and is to be found by adding together specific amounts (if any) which would be shown in respect of it in the "appropriate" balance sheet of C or P.

39. Subsection (2) identifies two amounts to be added together. These are the net book value (or carrying amount) of the relevant plant and machinery and where the relevant plant and machinery is leased to a lessee under one or more finance leases which are not long funding finance leases, the amounts shown in the appropriate balance sheet as the net investment in that lease or those leases.

40. Subsection (3) provides that where the plant and machinery is a fixture in any land and the net book value (or carrying amount) of the land would include an amount in respect of the fixture, then the net book value (or carrying amount) of the fixture is determined on a just and reasonable basis.

41. Subsection (4) provides a similar rule to subsection (3) where plant and machinery is leased under a finance lease along with any land or other assets which are not plant and machinery. The net investment in the lease in respect of the plant and machinery is determined on a just and reasonable basis.

42. Subsections (5) and (6) identify the appropriate balance sheet. The balance sheet has to be drawn up in accordance with generally accepted accounting practice so as to reflect the position at the beginning of the relevant day but adjusted for the disposal of any relevant plant and machinery that takes place on the relevant day.

Unallowable purpose

43. New section 212M sets out the unallowable purpose rule and defines the expressions used.

44. Subsection (1) gives the rule. The qualifying change has an unallowable purpose if the main purpose or one of the main purposes of the “change arrangements” is to “obtain a relevant tax advantage” for that person or any other person.

45. Subsection (2) explains what is meant by the phrase “change arrangements”. It includes any arrangements connected with or made to bring about the qualifying change.

46. Subsection (3) explains what is meant by “obtain a relevant tax advantage” in the context of a claim to allowances on unrelieved qualifying expenditure or making a claim under section 131 of CAA in respect of postponed allowances. It means a person becomes entitled to a reduction in profits or an increase in losses for tax purposes in consequence of the claim to allowances. The person becoming entitled to the reduction in profits is not limited to the person making the claim to allowances.

What happens when Chapter applies

47. New section 212N provides that when new Chapter 16A applies, an accounting period of C, or of a partnership P in which C was a member, or which succeeded to the trade previously carried on by C in circumstances in which Chapter 1 of Part 22 of CTA 2010 applies (previously section 343 of ICTA), ends and a new accounting period starts. This section defines what is meant by the terms “the old period” and “the new period”.

48. Subsection (1) gives the rule that the accounting period of C which is current on the relevant day ends with that day and a new accounting period of C begins with the following day.

49. Subsection (2) disapplies the rule in subsection (1) if condition A, B or D in new section 212C is met and the relevant trade was carried on by C in partnership with another company or other companies. In these circumstances, the rule is that the accounting period of the partnership which is current on the relevant day ends on that day. Where the partnership continues after the relevant day a new accounting period begins on the following day, or where condition D applies, and C’s share in the relevant trade is nil after the qualifying change, and the relevant trade is carried on by a company, a new accounting period of that company begins on the following day.

50. Subsection (3) explains that the accounting period which ends on the relevant day is the “old period” when considering the application of new section 212O.

51. Subsection (4) explains that accounting period which begins on the day following the relevant day is the “new period” when considering the application of new section 212P.

52. New section 212O explains how the amount of the excess of allowances in a pool is to be calculated – this is in order to consider the application of new section 212P. The calculation is done in two stages. The first stage requires a comparison of the unrelieved

expenditure in each pool with the balance sheet value of the assets in that pool. The unrelieved expenditure is as specified in new section 212K(2) for each single asset pool or class pool (not the total of such pools in either case) and in the main pool. This amount is referred to as "PA" in relation to each pool. The PA value is then compared to the BSVP - a just and reasonable apportionment of the total BSV, calculated under new section 212L - which is appropriate to attribute to that particular pool. If, on a pool by pool basis, PA is more than BSVP, then C or P has an excess of allowances in that pool (called a "relevant pool" in this section and in new section 212P) and the amount of the excess is the difference between PA and BSVP.

53. However, if for any other pool BSVP is greater that PA, then section 212O(5) provides that what would otherwise be the excess in a relevant pool may be reduced by the difference between BSVP and PA provided that difference has not already been taken into account in relation to another relevant pool or under new section 212Q(8). This is the second stage of the calculation. This ensures that the total of excess of allowances in each individual pool does not exceed the figure given by new section 212J.

54. New section 212P is the main provision that sets out what happens when C or P has an amount of excess allowances. Essentially the excess of allowances is treated as qualifying expenditure in a new pool. The way in which relief for allowances in respect of expenditure in new pools, or losses attributable to such allowances, can be claimed is then restricted.

55. Subsection (1) provides that the unrelieved expenditure in each relevant pool is taken to be reduced at the beginning of the new period by the amount of the excess of allowances in relation to the pool.

56. Subsection (2) then provides that the amount of excess is to be treated from the beginning of the new period as if it were qualifying expenditure in a new pool of the same description as the relevant pool.

57. Subsection (3) provides that after a qualifying change has taken place, as defined in new section 212C, any trade or part of a trade transferred into C or P is treated as a separate trade (from C's or P's original trade) for the purposes of claiming capital allowances in respect of qualifying expenditure in a new pool. As a result, capital allowances in respect of new pools cannot be claimed against C's or P's newly acquired trade (or part trade) activities.

58. Subsection (4) provides that where a claim to capital allowances in respect of a new pool creates or increases a loss, that loss may only be set off under section 37 of CTA 2010 against the profits from qualifying activities carried on by C, or by a company that is a member of P, at the start of the relevant day.

59. Subsection (5) provides also that the amount of loss (created or increased by capital allowances claimed in respect of expenditure in a new pool) set off under section 37 of CTA 2010 cannot exceed the amount that could have been set off in the absence of the qualifying change.

60. Subsection (6) provides that a loss attributable to capital allowances claimed in respect of new pool expenditure cannot be surrendered as group relief unless it could have been so surrendered but for the qualifying change.

61. Subsection (7) provides that the amount of loss surrendered as group relief under subsection (6) cannot exceed the amount that could have been set off in the absence of the qualifying change.

62. Subsection (8) is an anti-avoidance rule that prohibits a qualifying activity not actually carried on by C, or a company that is a member of P, at the start of the relevant day, but which would otherwise be regarded, for corporation tax purposes, as forming part of C or the company's qualifying activity at that time, from being so regarded for the purposes of subsection (4) above.

63. Subsection (9) provides that where condition C in new section 212C is met, then the reduction of qualifying expenditure in the relevant pools and the allocation of the excess of allowances looks at the pools transferred under section 948 of CTA 2010 (previously section 343 of ICTA) from C.

64. New section 212Q provides comparable rules (to those in new section 212P) in relation to postponed allowances. The legislation starts by treating all postponed allowances as being an excess of allowances (see paragraph 30 above) and calls them relevant postponed allowances. However, the excess of postponed allowances can be reduced if in any pool BSVP is more than PA and the difference between BSVP and PA has not been used to reduce the excess in any relevant pool (see paragraph 53 above). The section only has effect where the relevant day is on or after 9 December 2009.

65. The rules on restricting the set-off of excess postponed allowances are exactly the same as those for allowances from new pools. Subsections (4) to (7) provide that the postponed allowances cannot be included in any section 37 of CTA 2010 loss claim, nor can they be included in any amount surrendered as group relief, unless the amounts would have been available for set off or surrender but for the qualifying change.

66. New section 212R provides a rule that requires the disposal proceeds from the sale of any relevant plant and machinery to be apportioned between the new pool and the relevant pool on a just and reasonable basis.

67. New section 212S is an anti-avoidance provision that stops any person, other than C or P, claiming plant and machinery allowances on any asset acquired from C on the relevant day. This is because new section 212K(4)(c) provides that the disposal is ignored not only when calculating RTWDV, but also for the purposes of Part 2 of CAA. Without this provision it would have been possible for both C and the person acquiring the asset to get relief. The section only has effect where the relevant day is on or after 9 December 2009.

68. Paragraph 4 amends section 247 of CAA by introducing a new subsection that refers to the anti-avoidance rules in new Chapter 16A and so limits the ways in which effect may be given to an allowance.

69. Paragraph 5 explains that the amendments have retrospective effect where the relevant day is on or after 21 July 2009.

70. Paragraph 6 however provides that certain provisions only have effect from 9 December 2009. The provisions are those relating to companies with no principal company at the start of the relevant date, postponed allowances, transactions taking place on the relevant day that reduce the amount of unrelieved expenditure in a pool, and the denial of allowances where a person has acquired plant and machinery from C or P on the relevant day.

Background Note

71. Depreciation of fixed assets charged in the commercial accounts of a business is not allowed as a deduction in computing the taxable profits. Instead capital allowances may be given at prescribed rates on certain assets, including plant and machinery. The annual investment allowance provides an annual 100 per cent allowance for the first £100,000 of investment in plant and machinery to all businesses. There are also 100 per cent first-year allowances available for certain types of expenditure. Otherwise expenditure on plant and machinery attracts writing-down allowances (WDA).

72. Qualifying expenditure has to be allocated to the appropriate pool for the purpose of determining entitlement to WDA. A pool may cover a single asset (for example ships or short-life assets) or a class of assets (special rate pools and overseas leasing pools are examples of class pools). Any expenditure qualifying for plant and machinery allowances that does not fall to be allocated to a single asset pool or a class pool is

allocated to the main pool. The rate of WDA for expenditure in the special rate pool is 10 per cent per annum, otherwise WDA is given at 20 per cent per annum.

73. Pooling works by keeping a running total of available qualifying expenditure in a pool. WDA is given on the balance of expenditure incurred in previous periods as yet unrelieved, plus any new expenditure in the period less any disposal proceeds to be brought into account for that period. This is the reducing balance basis. Plant and machinery allowances are broadly intended to give relief for the reduction in value of an asset while a company owns it. It is unlikely that WDA alone will achieve exactly this and balancing allowances or balancing charges are given to adjust the relief to give this result.

74. Capital allowances are deducted from profits and they may create or enhance a loss. Trading losses may be utilised in several ways. They may be surrendered as group relief, and so used to reduce the profits of companies other than the one that incurred the expenditure. They may also be set sideways against other profits (of the company incurring the losses) of the same year or carried backwards to reduce the profits of the company for an earlier year. Any remaining losses are carried forward to reduce the company's profits from the same trade in subsequent years; they cannot be set against other profits of the company or against the profits of other companies in these subsequent years.

75. A company does not have to claim its maximum entitlement to capital allowances in any period, but instead may preserve the amount on which they may be claimed for a later period. This allows the company, and indeed its group, to decide when to make a claim in order to maximise the value of the capital allowances in reducing other profits.

76. There have been a number of transactions in which companies with large pools of unclaimed capital allowances have been sold into a new group principally to enable the new group to access the allowances in the form of group relief. While there is flexibility in the capital allowances code over the timing of a claim as described above, (paragraph 31) it is not the intention that tax assets in the form of unclaimed allowances be sold .

77. If a company claims its maximum entitlement to capital allowances each year and, in doing so, creates or enhances a loss that cannot be relieved, a group acquiring the company would not be able to access the losses as group relief, as explained in paragraph 74 above. There is also specific legislation to counter loss buying where a person buys a trading company wholly or partly for its unused losses rather than solely for the inherent value of its trade or assets; this legislation prohibits the losses being utilised against any new activities introduced into the company.

78. The legislation introduced by this Schedule is consistent with the rules to deter loss buying transactions and will restrict the way in which capital allowances can be utilised following a transfer of entitlement to benefit from those capital allowances. Capital allowances or any loss attributable to a capital allowances claim will only be available to reduce the profits that they would have been able to reduce before the transaction took place. The legislation will, however, only apply where the main purpose or one of the main purposes of the transaction is to obtain a tax advantage.

79. There are three other conditions that must be met for the legislation to take effect (that is, in addition to the unallowable purpose test). A company must carry on a trade or carry on a trade in partnership with others, that company (or that partnership) must have an excess of capital allowances and there must be a qualifying change in relation to the company.

80. Broadly, a qualifying change is either the sale or partial sale (to create a consortium) of a company, a change in the ownership proportions of a consortium company, a change in the profit sharing ratio of a partnership or a transfer of the trade (with the excess of allowances) in circumstances such that the *Transfers of a trade without a change*

of ownership provisions (in Chapter 1 of Part 22 of CTA 2010) apply. Any of these transactions could be used to transfer an entitlement to capital allowances.

81. If a company has not claimed its maximum entitlement to capital allowances it is likely that the tax written down value (that is, the expenditure in a pool unrelieved) of the plant and machinery will be greater than its value shown on the balance sheet. The amount by which the tax written down value exceeds the balance sheet value is the excess of allowances.

82. The legislation operates by allocating an amount of expenditure equal to the excess of allowances in each pool to a new separate pool of the same type (i.e. a new single asset, class or main pool). WDA are calculated on the old and the new pools separately but at the same rate. If, however, in respect of another pool the balance sheet value of plant and machinery is greater than its tax written down value, then this difference can be used to reduce the excess of allowances in a pool. There are anti-avoidance rules to prevent the manipulation of the tax written down value and the balance sheet value used in the calculation to contrive a reduced excess of allowances.

83. To enable the excess of allowances to be calculated the company's (or the partnership's) accounting period is brought to an end on the day of a qualifying change and a new accounting period begins on the following day.

84. Capital allowances claimed in respect of expenditure in the new pools may only be used to reduce the profits (or increase the losses) from the trade as it was carried on, and to the extent that it was carried on, before the qualifying change. Any trading activities transferred in to the company or the partnership will be treated as a separate trade for these purposes.

85. Any losses attributable to capital allowances on new pool expenditure may not be surrendered as group relief or set against other profits of the company for the year, unless they could have been used to reduce those profits before the qualifying change.

86. There are special capital allowances rules for ships that allow capital allowances to be claimed and then postponed so that the capital allowances are given in a subsequent year. Postponed allowances that have not yet been relieved will be subject to the same rules as the amounts of excess allowances.

87. In summary, this legislation is designed to prevent a company or group acquiring a company, or an increased share in a company or partnership, or a trade for the purpose of accessing the capital allowances, actually obtaining relief for those capital allowances against its existing profits. Relief for the capital allowances can, however, still be given after the change in ownership transaction but only to reduce the same profits and to the same extent that they could have reduced before the change. The benefit of the avoidance transaction is thus removed in a fair and proportionate way.