

Back to basics

Capital allowances: s 198 elections

Speed read

CAA 2001 s 198 elections have been around for decades, but they are still often misunderstood, under-utilised and completed incorrectly. The purpose of a s 198 election is relatively simple, but hugely important: the lack of a s 198 election in certain circumstances could mean no capital allowances are available to a buyer on even the largest of commercial property transactions, and equally could result in a large disposal value to be recognised by the seller, resulting in unintended balancing charges and a clawback of the capital allowances claimed.



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Background: capital allowances disposals

Capital allowances are available for UK taxpayers who incur qualifying capital expenditure on certain asset classes. Accounting depreciation for capital expenditure incurred is generally non-tax deductible, with tax depreciation for tangible fixed assets being available in the form of capital allowances.

The most common capital allowance claimed is plant and machinery allowances (under CAA 2001 Part 2). Most practitioners will be very familiar with claims for plant and machinery allowances, what assets can qualify for the relief and how these allowances are claimed, i.e. at the main rate (CAA 2001 s 54) and special rate (CAA 2001 s 104C) pools, and as writing down allowances on a reducing balance basis or as part of the annual investment allowance (AIA) threshold (CAA 2001 s 51A).

A taxpayer who has claimed or pooled plant and machinery allowances must recognise a disposal value when a disposal event occurs (CAA 2001 s 61 (for general plant and machinery) and s 196 (for fixtures and integral features)). The most common disposal event will be the sale of the asset or property that contains fixtures, but CAA 2001 also contains provisions for the disposal value to be recognised when plant and machinery is demolished, starts to be used for another purpose, or is abandoned. The disposal value that needs to be recognised depends on the nature of the disposal event.

The original purpose of s 198 elections

Whilst s 198 elections are commonplace in commercial property transactions, strictly speaking they apply only for fixtures that are sold at market value as part of the sale of the interest in a property (freehold, leasehold or other relevant interest in land held, in accordance with CAA 2001 s 175).

By default, where a property is sold at or above market value and contains fixtures in respect of which the seller has made a claim for capital allowances, the seller's disposal value is the net proceeds of sale of the fixtures, and represents the amount of the price the buyer has also paid. The amount of the net proceeds of sale for the fixtures is determined on a 'just and reasonable' apportionment basis (CAA 2001 s 562). Further, disposal values are restricted to the original cost for the taxpayer disposing of the fixtures (CAA 2001 s 62). For the buyer of the property which contains the fixtures in respect of which the seller has claimed allowances, the claim is restricted to the seller's disposal value for the fixtures (CAA 2001 s 185).

Section 198 elections are, in effect, an alternative disposal value for fixtures. They supersede the default disposal value (i.e. the proceeds of sale for the fixtures, which is determined by CAA 2001 s 562 apportionment), and they act as both the buyer's purchase price for the fixtures and the seller's disposal value to be recognised in their tax returns.

The pooling and fixed value requirements

The requirement for a buyer to limit the purchase price paid for fixtures to the seller's disposal value only applied if the seller, or a prior owner, had actually pooled or claimed plant and machinery allowances for the fixtures. If a buyer determined that the seller, or no prior owner who owned the fixtures after 24 July 1996, had claimed allowances, there was no need to restrict their claim or enter into a s 198 election. The buyer could be entitled to claim the plant and machinery fixtures on an unrestricted apportionment of the purchase price paid (in accordance with CAA 2001 s 562).

Section 198 elections have become much more important following the introduction of 'fixed value' and 'pooling' requirements in CAA 2001 s 187A and s 187B. The fixed value requirement (mandatory from April 2012) means that a seller and buyer have to agree the disposal value of fixtures in respect of which the seller has made a claim, either by tribunal decision or by agreeing and entering into a s 198 election.

The pooling requirement (mandatory from April 2014) means that where the seller is entitled to make a claim for fixtures, the value of the fixtures has to be pooled by the seller in a tax return, i.e. within the main or special rate pool.

Where the provisions of CAA 2001 ss 187A and 187B apply but are not met, the buyer is treated as incurring nil expenditure on the fixtures, and the seller will need to recognise a disposal value (if they made a claim) in the normal way (i.e. under CAA 2001 s 61 and s 196).

Unless the seller values the capital allowances available for fixtures, adds these to the relevant pools, and then agrees a s 198 election, buyers of the fixtures will have no capital allowances to claim in the future. The only alternative is to apply to the tribunal, which can prove time consuming and expensive.

Content requirements

Under CAA 2001 s 201, a valid s 198 election must contain:

- the disposal value of the fixtures to be fixed by the election;
- the name of each of the taxpayers jointly entering into making the election;
- information sufficient to identify the fixtures to which the election relates;
- information sufficient to identify the relevant land upon which the fixtures are installed;
- the relevant interest acquired by the purchaser (e.g. freehold and long leasehold); and
- both taxpayers' unique taxpayer references (UTR), and/or confirmation if any party does not have a UTR.

An election that does not meeting these statutory requirements is invalid, and it does not therefore evidence the seller's disposal value or the buyer's purchase price for the fixtures. In such a case, the seller will have to recognise a different (often higher) disposal value, and the buyer, due to the fixed value requirements, will have to recognise nil as the purchase price paid for the fixtures. It is therefore imperative that s 198 elections are completed correctly.

Strictly speaking, s 198 elections should be prepared on a fixture by fixture basis. However, HMRC accepts 'a degree' of amalgamation of assets within a property, but they must be split between the main rate pool and the special rate pool. HMRC will not, though, accept a single election drafted to include 'all fixtures within a property' portfolio (see HMRC's *Capital Allowances Manual* at CA26850).

The legislation does not require the election to be signed, but in practice an election signed by both buyer and seller is often the easiest way to evidence the requirement that it was jointly entered into. If an election is not signed, separate evidence is required to demonstrate it was jointly entered into (for example, by being part of a sale and purchase agreement, or evidence of the election being exchanged between a seller and a buyer and/or their legal representatives).

Time limits

An election must be jointly entered into and submitted to HMRC within two years of the date of transaction (CAA 2001 s 201). There is an exception if either party applies to the tribunal to determine the disposal value, so the time limit is extended until the tribunal has decided the matter. Once made, the election is irrevocable. Section 198 elections must also be included in the tax return for the period in which the property is sold or purchased by both the seller and the buyer, respectively.

Minimum and maximum value

There is no minimum value for a s 198 election, but in practice the minimum disposal value that is recognised is often £1 for the respective pools, or £2 in total. A nil disposal value is seldom seen, perhaps most importantly because the election and the election disposal value does need to be actually brought in and recognised by the seller in the tax return for the period of disposal. A nil disposal value within an election may easily be overlooked, with the election not submitted and the nil disposal value not recognised. In this scenario, the seller has not included the election in their return, as required under CAA 2001 s 201. If a disposal has not been recognised within the return, HMRC could, under enquiry, force the seller to recognise

a different disposal value. The maximum value for a s 198 election will be the seller's original cost for the fixture, which is the maximum disposal value a seller can recognise under CAA 2001 s 62.

Final thoughts

Section 198 elections are now common practice for most commercial property transactions, and they are included as an appendix or schedule in sale and purchase contracts. They are often the simplest way for a seller and buyer to meet the stringent fixed value requirements of CAA 2001 s 187A, which have been fully applicable to all tax paying sellers, even those who have not made a claim for allowances, since April 2014.

All too often, s 198 elections are not prepared correctly, or are sometimes made when an election is not available. Whilst HMRC enquiries into s 198 elections are rare, there is a real financial risk of relying on an invalid election. A buyer's claim could be reduced to nil, and HMRC could look to enforce an alternative (perhaps higher) disposal value on a seller.

The amount to be fixed by an election can be anywhere from £1 or £2 up to the seller's original cost. This is a point that is often overlooked during commercial negotiations on the sale of the property. If considered at the appropriate time, it gives the buyer and seller the opportunity to negotiate the elected values, based on their respective tax positions.

This is especially pertinent given the new (temporary) 130% 'super-deduction' and 50% 'special rate (SR) allowance' announced in Budget 2021. These allowances are available for expenditure on new and unused plant and machinery between April 2021 and March 2023. The super-deduction is available for main pool plant and machinery, and the SR allowance on special rate plant and machinery (with some exclusions, such as cars and leased plant and machinery).

Expenditure qualifies as main pool or special rate pool plant and machinery in the same way as before; the new first year allowances only operate to accelerate the rate at which tax relief is realised. The disposal values for plant and machinery claimed as either the super-deduction or SR allowance are also arrived at in the same way, i.e. through CAA 2001 s 61 and s 196 (in accordance with Finance Bill 2021 clause 12). A key difference, however, is that whilst the disposal value is arrived at in the same way, the amounts incurred on plant claimed as either 'super-deduction' or 'SR allowance' is automatically a balancing charge.

As allowances and disposal values are calculated in the same way, it will be possible to use a s 198 election as an alternative disposal value for fixtures that qualified and are claimed as a super deduction or SR allowance. This is an important point, as for sellers of fixtures claimed under these new first year allowances, the balancing charge realised would be heavily mitigated – potentially as low as £1 or £2, or lower still where only part of the cost of the plant and machinery has been claimed under the new temporary first year allowances. ■

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