These notes refer to the Capital Allowances Act 2001 (c.2) which received Royal Assent on 22nd March 2001

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Plant and machinery allowances

Overview

78. This Part provides for plant and machinery allowances. These can be first-year allowances, writing-down allowances or balancing allowances. It also provides for balancing charges.

79. Chapters 1 to 3 set out provisions which decide if a person is in a position to claim allowances. Chapter 1 gives first the general rule that a person must have a qualifying activity and qualifying expenditure. It also gives the general rule as to what is qualifying expenditure and some common additional ways a person may be treated as having incurred it. Chapter 2 defines qualifying activities. Chapter 3 makes more detailed provisions as to what is and is not qualifying expenditure.

80. Chapter 4 identifies expenditure which gives entitlement to first-year allowances. This is called first-year qualifying expenditure.

81. Chapter 5 deals with entitlement to first-year allowances, writing-down allowances and balancing allowances; and with liability to balancing charges. Before writing-down allowances can be claimed, qualifying expenditure must be allocated to a pool. Entitlement to allowances or liability to charges then depends on the total amount in the pool. There are separate pools for each qualifying activity. Within each qualifying activity there may be a main pool; class pools for long-life assets and for assets leased outside the UK; and a number of single asset pools. Figure 1 summarises the various pools.

82. Chapters 6 to 16 make additional provisions for particular types of expenditure and for particular circumstances in which plant or machinery is used or subsidised. They modify the requirements of the earlier Chapters. Chapters 8 to 16 require expenditure to be allocated to class pools or single asset pools rather than the main pool for a qualifying activity.

83. Chapter 17 restricts entitlement to plant and machinery allowances in various circumstances.

84. Chapter 18 deals with additional VAT rebates or liabilities under the VAT capital goods scheme. This scheme applies to certain expenditure on land and computers.

85. Chapter 19 sets out how plant and machinery allowances are given effect.

86. Chapter 20 contains supplementary provisions.

History

87. Annual allowances for plant and machinery used in a trade were introduced in 1878. In 1907 a rule was added to prevent the total relief given in respect of an asset from exceeding its cost.

88. In 1945 the first allowances at rates in excess of normal depreciation were introduced to encourage investment.

89. Since 1971, the legislation has referred to accelerated allowances for the period in which expenditure is incurred as "first-year allowances".

90. FA 1984 phased out first-year allowances as part of a wide-ranging reform of business taxation. First-year allowances at 40% were re-introduced for one year in 1992-93. In 1997 they were re-introduced for one year at 50% for spending by small and medium-sized businesses only. This was extended, at 40%, for 1998-99 and 1999-2000. In FA 2000 the allowances were made indefinite.

91. First-year allowances have also been introduced, on a temporary basis, for expenditure by small and medium-sized enterprises on plant and machinery for use in Northern Ireland and by small enterprises on information and communication technology equipment.

92. Balancing allowances and balancing charges were also introduced in 1945 to bring the total allowances given on an asset into line with the total depreciation over the period the plant or machinery is owned. This is a principle running through Part II of CAA 1990 – and hence this Part.

93. The calculation of writing-down allowances and balancing adjustments for plant and machinery changed fundamentally in 1971 with the introduction of a statutory scheme of pooling. Expenditure on plant or machinery (less any first-year allowances made) is pooled. Writing-down allowances are then given at a single annual rate on the total of this "qualifying expenditure" in the pool. Pooling simplifies calculations and records. It also removes the need for lots of small balancing adjustments when individual items of plant or machinery are sold, scrapped or otherwise disposed of.

94. In 1971 all expenditure was allocated to the main pool apart from expenditure on cars above the cost threshold, plant or machinery provided or used partly for a trade and partly for other purposes and plant or machinery subject to a wear and tear subsidy. These exceptions kept separate expenditure on a single item of plant or machinery. More such "single asset pools" were added in later years. So too were "class pools" for all expenditure of a given type. The pools added were:

- class pool for leased assets and cars below the cost threshold in FA 1980 (abolished by FA 2000);
- class pool for overseas leasing in FA 1982 (which also modified the class pool introduced in 1980);
- single asset pools for ships in FA 1985;
- single asset pools for short-life assets in FA 1985; and
- class pool for long-life assets in FA 1997.

95. Originally allowances were given only for plant and machinery used in trades. In 1945 the legislation provided also for professions, vocations, employments and offices to be treated like trades with some modifications; and in some circumstances for plant and machinery allowances for lessors. Over the years allowances were extended to other businesses by treating them like trades too – again subject to modifications and conditions.

96. What counts as plant and machinery has also evolved over the years – partly because of judicial decisions and partly by legislation.

Structure of Part 2

97. One way in which CAA 1990 copes with the extensions to the scope of plant and machinery allowances is by treating activities such as professions, vocations and property businesses as if they were trades.

98. Separate pools for expenditure are achieved in CAA 1990 by a similar device. Expenditure incurred for the purposes of a trade (or an activity treated as a trade) is treated as incurred for a separate notional trade.

99. This works. But it means that what appear to be simple references to a trade may mean something more. For example Part II of CAA 1990 starts with the simple statement in section 22:

"(1) Subject to the provisions of this Part, where—
   (a) a person carrying on a trade incurs capital expenditure to which this section applies on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and
   (b) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure,

there shall be made to him for that period an allowance ("a first-year allowance") …

100. This might lead readers not carrying on a trade to conclude they are not entitled to first-year allowances. But later sections in CAA 1990 mean that the "trade" in paragraph (a) does not have to be a trade. It may be another activity treated as a trade.

101. Similarly readers might take section 24 of CAA 1990 to mean they are not entitled to writing-down allowances if they are not carrying on a trade:

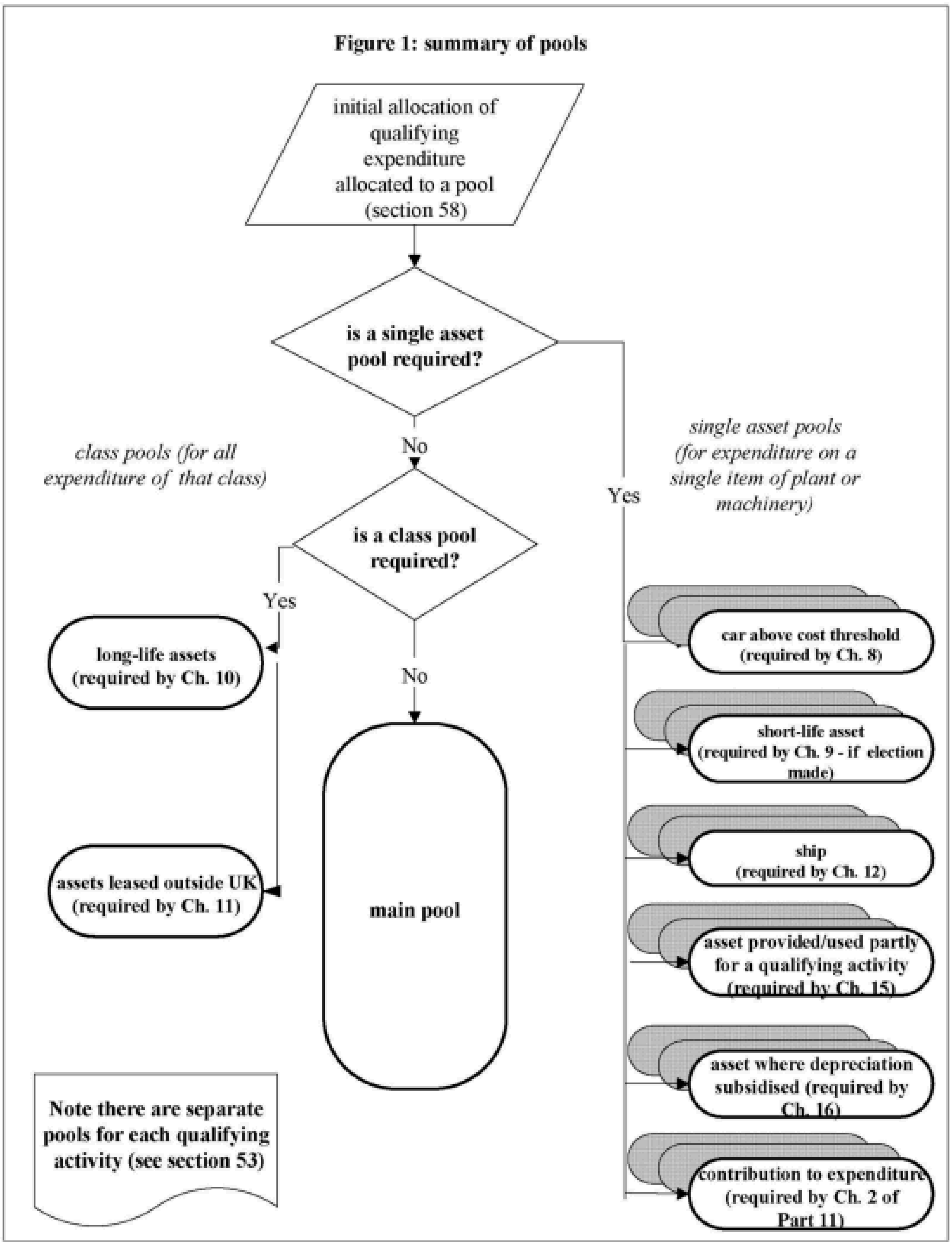
"(1) Subject to the provisions of this Part, where—
   (a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and
   (b) in consequence of his incurring that expenditure, the machinery or plant belongs or has belonged to him,

allowances and charges shall be made to and on him in accordance with the following provisions of this section.

102. In fact the "trade" can again be another activity treated as a trade. It may also be a notional trade set up so as to create a separate pool of expenditure. In addition, expenditure which is not on plant or machinery may be treated as if it were under later provisions; or people may be treated as incurring expenditure on plant or machinery they have as a result of a gift.

103. A different approach is taken to these points in this Act. It:

- deals explicitly with the various activities which CAA 1990 treats as or deems to be trades. The term "qualifying activity" is used to refer to these. See section 15.
- deals explicitly with "pools" in place of notional trades (or notional qualifying activities as they would have become); and
- makes clear to readers coming to Part 2 (possibly for the first time) what is required for entitlement to allowances.



104. The structure of Part 2 of this Act is accordingly different from Part II of CAA 1990. There are three main blocks of sections:

- Chapters 1 to 3 deal with qualifying activities and qualifying expenditure. A person who has a qualifying activity and qualifying expenditure is normally entitled to allowances of some kind;

- Chapters 4 to 18 deal with the entitlement to allowances (or liability to charges). The order of this material is a balance between several criteria: for example how often the legislation applies in practice; the benefits of putting similar provisions together; introducing concepts in a logical order; and readers' expectations. There is no one right answer as a different mix of provisions is relevant to different taxpayers, and to different transactions by one taxpayer; and

- Chapter 19 then sets out how allowances are given effect.

105. Another difference in approach in this Act from CAA 1990 is in the use of the term "qualifying expenditure".

106. Part II of CAA 1990 uses this term to mean the sum of expenditure added to a pool for a chargeable period plus the balance (if any) of expenditure added in earlier chargeable periods. The expenditure added to a pool may be the same amount as the capital expenditure incurred on plant or machinery. But it may also be less. A simple example is if a first-year allowance is claimed. Then the amount which counts as qualifying expenditure in CAA 1990 is the balance left after the first-year allowances.

107. There is no term in CAA 1990 for the amount of expenditure on which someone can get allowances of one kind or another – first-year allowances and/or writing-down allowances. It is not the capital expenditure incurred as not all capital expenditure qualifies. So Part II of CAA 1990 has repeatedly to refer to expenditure by its characteristics. An example is section 37(1) of CAA 1990.

"(1) This section applies where—

(a) a person carrying on a trade ("the trader") incurs capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade;

108. In this Act qualifying expenditure means expenditure on which a person may get first-year allowances or writing-down allowances (or both). This is broadly in line with other Parts of this Act which also use the term qualifying expenditure (although what is and is not qualifying expenditure differs from Part to Part). Using the term qualifying expenditure in this way allows simpler references. An example is in section 83.

"Plant or machinery in respect of which qualifying expenditure has been incurred is a short-life asset if—

109. Other terms then follow from this use of qualifying expenditure. The table below is a simplified summary.

in this Act	***in CAA 1990***
qualifying expenditure (see section 11)	no equivalent term: broadly capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of a trade which belongs to the person incurring it (see section 25(1)(a))
available qualifying expenditure (see section 57)	qualifying expenditure
unrelieved qualifying expenditure (see section 59)	no equivalent term: section 25(1)(b) provides that qualifying expenditure includes "if for the chargeable period immediately preceding the chargeable period in question there was an excess of qualifying expenditure over disposal value, the balance of that excess after deducting any writing-down allowance made by reference thereto".

Chapter 1: Introduction

Overview

110. This Chapter introduces Part 2 by giving the general conditions for plant and machinery allowances and dealing with some common additional cases.

111. Section 11 identifies the general requirement for plant and machinery allowances: a person must carry on a qualifying activity for which they incur qualifying expenditure. If a person carries on more than one qualifying activity each is looked at separately to decide entitlement to allowances. These general rules are subject to other provisions which amend or replace them in various circumstances.

112. Sections 12 to 14 provide for plant and machinery allowances if a person does not meet the general conditions because:

- expenditure was incurred before the start of the qualifying activity in question;
- expenditure was incurred for another purpose before the plant or machinery starts to be used for the qualifying activity; or
- plant or machinery used for a qualifying activity was a gift.

Section 11: General conditions as to availability of plant and machinery allowances

113. This section is based in part on sections 22(1)(a) and 24(1)(a) and (b) of CAA 1990. It gives the general conditions for plant and machinery allowances. It uses the terms “qualifying activity” and “qualifying expenditure” which are central to entitlement to allowances under this Part.

114. *Subsection (1)* sets out the preliminary requirement for the whole of Part 2. Allowances are available if a person carries on a qualifying activity and incurs qualifying expenditure.

115. *Subsection (2)* is a signpost to Chapter 2 of Part 2 which gives the meaning of “qualifying activity”.

116. *Subsection (3)* sets up separate calculations for each qualifying activity.

117. *Subsection (4)* gives the general rule for qualifying expenditure. Subsection (4)(a) uses “wholly or partly” for the purposes of the qualifying activity instead of “wholly and exclusively” used by sections 22(1)(a) and 24(1)(b) of CAA 1990. The use of that term at the start of Part II is potentially misleading. Readers may conclude they are not entitled to plant and machinery allowances if they use an asset partly for other purposes. Yet section 79 of CAA 1990 makes explicit provision for allowances for plant or machinery provided or used partly for a qualifying activity and partly for other purposes. This subsection flags this at the start.

118. Subsection (4)(b) uses “owns”. CAA 1990 refers to plant or machinery which “belongs” to a person in sections 22(1)(b) and 24(1)(b) (and elsewhere). This is a change in the language only. See *Note 7* in Annex 2.

119. *Subsection (5)* is a signpost to Chapter 3 of Part 2 which contains detailed provisions about plant and machinery and qualifying expenditure.

Section 12: Expenditure incurred before qualifying activity carried on

120. This section is based on section 83(2) of CAA 1990. It provides for expenditure incurred before the qualifying activity is carried on to be treated as incurred when the activity is started. Without this the expenditure could not be qualifying expenditure. It complements the trading income rule in section 401 of ICTA.

Section 13: Use for qualifying activity of plant or machinery provided for other purposes

121. This section is based on section 81(1) to (2AB) of CAA 1990. It provides for a person to be treated as having incurred qualifying expenditure if they start to use in a qualifying activity plant or machinery they provided for some other purpose. Without this section such plant or machinery would give no entitlement to allowances.

122. Section 81 of CAA 1990 also deals with gifts. In this Act they are dealt with in section 14. Dividing the material in this way brings out for readers the distinct ways they may be entitled to allowances.

Section 14: Use for qualifying activity of plant or machinery which is a gift

123. This section is based on section 81 of CAA 1990. It contains rules for plant or machinery that was gifted to the person carrying on the qualifying activity.

124. The section is similar to section 13. The plant or machinery received as a gift comes in at market value.

125. There is no equivalent of the anti-avoidance rules in section 13(4) and (5).

126. The anti-avoidance rule in section 81(3) of CAA 1990 has been moved to Chapter 17 of Part 2 – see section 213(3).

Chapter 2: Qualifying activities

Overview

127. This Chapter determines whether or not a person is carrying on a qualifying activity. This is a necessary condition of entitlement to plant and machinery allowances (see Chapter 1 of Part 2).

128. Section 15 lists the qualifying activities. It also points to provisions in Chapters 3 and 8 of Part 2 which affect particular qualifying activities.

129. The rest of this Chapter contains definitions of, and further provisions about, particular qualifying activities.

Section 15: Qualifying activities

130. This section is based on various sections of CAA 1990 which deem the activities listed to be trades. It also makes a minor change.

131. *Subsection (1)(f)* makes concerns listed in section 55 of ICTA a type of qualifying activity. The profits of these concerns are charged to tax under Case I of Schedule D by section 55(1) of ICTA but are not trades. As they are taxed under Schedule D they cannot be Schedule A businesses. That means Part II of CAA 1990 does not cater for them. This Act does so by making them qualifying activities. See *Change 1* in Annex 1.

132. *Subsection (1)(g)* provides for the management of an investment company to be a qualifying activity. It derives from section 28(1) of CAA 1990 which refers to “the management of the business of an investment company”. This is new wording but is not a change. See *Note 8* in Annex 2.

133. The final words provide that an activity is only a qualifying activity to the extent that the profits or gains from it are chargeable to tax. They are based on section 83(2A) of CAA 1990. Exceptions to this rule can be found in Chapters 16, 17 and 20 of Part 2.

Section 16: Ordinary Schedule A businesses

134. This section defines "ordinary Schedule A business" for the purposes of this Part. This term is not used in CAA 1990. It is used in this Act to distinguish Schedule A businesses which are not furnished holiday lettings businesses from those which are.

Section 17: Furnished holiday lettings businesses

135. This section is based on section 29 of CAA 1990. It defines furnished holiday lettings businesses.

136. *Subsection (3)* applies the definition in section 504 of ICTA. This approach is taken here (and in some other places in the Act) in order to:

- make clear that precisely the same definition is used; and
- avoid duplication of legislation (with the risk that the definitions may diverge if one is amended but not the other by accident rather than design).

137. The vast majority of readers have access to that legislation. Increasingly they have electronic access (with hyperlinks to such cross-references). But for ease of reference in these notes:

Section 504 of ICTA (Supplementary provisions)

"(2) A letting—
(a) is a commercial letting if it is let on a commercial basis and with a view to the realisation of profits; and
(b) is of furnished accommodation if the tenant is entitled to the use of furniture.

(3) Accommodation shall not be treated as holiday accommodation for the purposes of this section unless—
(a) it is available for commercial letting to the public generally as holiday accommodation for periods which amount, in the aggregate, to not less than 140 days;
(b) the periods for which it is so let amount in the aggregate to at least 70 days; and
(c) for a period comprising at least seven months (which need not be continuous but includes any months in which it is let as mentioned in paragraph (b) above) it is not normally in the same occupation for a continuous period exceeding 31 days.

(4) Any question whether accommodation let by any person other than a company is, at any time in a year of assessment, holiday accommodation shall be determined—
(a) if the accommodation was not let by him as furnished accommodation in the preceding year of assessment but is so let in the following year of assessment, by reference to the 12 months beginning with the date on which he first so let it in the year of assessment;
(b) if the accommodation was let by him as furnished accommodation in the preceding year of assessment but is not so let in the following year of assessment, by reference to the 12 months ending with the date on which he ceased so to let it in the year of assessment; and
(c) in any other case, by reference to the year of assessment.

(5) Any question whether accommodation let by a company is at any time in an accounting period holiday accommodation shall be determined—
(a) if the accommodation was not let by it as furnished accommodation in the period of 12 months immediately preceding the accounting period but is so let in the period of 12 months immediately following the accounting period, by reference to the 12 months beginning with the date in the accounting period on which it first so let it;

(b) if the accommodation was let by it as furnished accommodation in the period of 12 months immediately preceding the accounting period but is not so let by it in the period of 12 months immediately following the accounting period, by reference to the 12 months ending with the date in the accounting period on which it ceased so to let it;

(c) in any other case, by reference to the period of 12 months ending with the last day of the accounting period.

(6) Where, in any year of assessment or accounting period, a person lets furnished accommodation which is treated as holiday accommodation for the purposes of this section in that year or period ("the qualifying accommodation"), he may make a claim under this subsection, within the time specified in subsection (6A) below, for averaging treatment to apply for that year or period to that and any other accommodation specified in the claim which was let by him as furnished accommodation during that year or period and would fall to be treated as holiday accommodation in that year or period if subsection (3)(b) above were satisfied in relation to it.

(6A) The time mentioned in subsection (6) above is—

(a) in the case of a claim for the purposes of income tax, the period ending with the first anniversary of the 31st January next following the year of assessment in which the accommodation was let;

(b) in the case of a claim for the purposes of corporation tax, the period of two years beginning at the end of the accounting period in which the accommodation was let.

(7) Where a claim is made under subsection (6) above in respect of any year of assessment or accounting period, any such other accommodation shall be treated as being holiday accommodation in that year or period if the number of days for which the qualifying accommodation and any other such accommodation was let by the claimant as mentioned in subsection (3)(a) above during the year or period amounts on average to at least 70.

(8) Qualifying accommodation may not be specified in more than one claim in respect of any one year of assessment or accounting period.

(9) For the purposes of this section a person lets accommodation if he permits another person to occupy it, whether or not in pursuance of a lease; and "letting" and "tenant" shall be construed accordingly.

138. *Subsection (4)* provides for all necessary apportionments under this Part if only part of accommodation is holiday accommodation.

Section 18: Management of investment companies

139. This section is based on section 28 of CAA 1990. It defines the qualifying activity of "management of an investment company".

140. Subsection (1) applies the definition of an investment company in ICTA. An investment company may carry on a trade or other qualifying activity. But subsection (2) provides that it is only a limited range of activities which are the "management of an investment company". These are activities expenditure on which would fall within "expenses of management" in section 75 of ICTA. This defines the qualifying activity for capital allowances in line with the treatment of expenses.

141. Section 28(1) of CAA 1990 refers to "the management of the business of an investment company". This has been shortened in this section and section 15(1)(g) to "management of an investment company". This does not change the effect of the legislation. See *Note 8* in Annex 2.

Section 19: Special leasing of plant or machinery

142. This section is based on section 61(1) of CAA 1990 and section 434E(2) of ICTA. It defines the qualifying activity of "special leasing" for plant or machinery which is hired out otherwise than in the course of any other qualifying activity.

143. *Subsection (1)* introduces and defines the term "special leasing". This term is not used in CAA 1990. That provides for such an activity to be treated as a trade separate from any other trade the person carries on. Other provisions then have to refer to such activities in terms of the legislation which define them. For example in section 31(1)(c) of CAA 1990:

"the actual trade is not a separate trade which the shipowner is treated as carrying on by virtue of section 61(1).

144. The term "special leasing" allows more direct references – see for example section 128(2).

145. The section refers to "hiring out" plant or machinery. CAA 1990 refers to plant or machinery "let". The use of the more colloquial phrase makes no practical difference. The section also omits the words in section 61(1) of CAA 1990 which provide that it does not matter whether the lessee does or does not carry on a qualifying activity. These are no longer needed. See *Note 9* in Annex 2.

146. *Subsection (3)* is based on section 61(1)(b) of CAA 1990. It states when the separate qualifying activity is permanently discontinued. This is not clear in CAA 1990. Section 61(1)(b) of CAA 1990 provides for the plant or machinery to be treated as being used wholly for purposes other than those of the deemed trade when the lessor permanently ceases to let the plant or machinery otherwise than in the course of a trade. This requires the lessor to bring a disposal event into account. But it does not explicitly provide for the deemed trade to be permanently discontinued. However, any other interpretation would leave the lessor with:

- no entitlement to a balancing allowance;
- entitlement only to writing-down allowances for an indefinite period, in ever decreasing amounts; and
- possibly allowances which are stranded because the lessor could only use them against income from letting the plant or machinery in question.

147. Subsection (3) accordingly reflects the alternative view that section 61(1) of CAA 1990 also provides for the deemed trade to end. See *Change 15* in Annex 1.

148. *Subsection (5)* is based on section 434E(2) ICTA. That (and section 434D ICTA) were introduced by section 51 of, and Schedule 8 to, FA 1995. As the legislation relates directly to capital allowances it is incorporated in this Act.

149. Section 61(8) of CAA 1990 is omitted from this section. It provides for a "lease" to mean also an agreement for a lease. It is now unnecessary except in relation to section 61(4) of CAA 1990 (see section 70 and paragraph 353 below).

Section 20: Employments and offices

150. This section is based on sections 198(2) and 314 of ICTA. It provides that some employments and offices are not qualifying activities as such.

151. *Subsection (1)* is based on section 314 of ICTA (divers and diving supervisors). Divers and diving supervisors operating in the North Sea normally have contracts of employment as a matter of general law. They would then be employees for tax purposes. But section 314 of ICTA provides that "the Income Tax Acts shall have effect as if" they were carrying on a trade. CAA 1990 is part of the "the Income Tax Acts" as

defined in section 831(1)(b) of ICTA. So for the purposes of the capital allowances legislation North Sea divers have trades rather than employments. Subsection (1) puts this explicitly in terms of qualifying activities.

152. *Subsections (2)* and *(3)* are based on section 198(2) of ICTA. They exclude from plant and machinery allowances employments and offices which are taxed on the "remittance basis" – that is, where only income remitted to the United Kingdom is taxed. Such remittances will already be net of any capital expenditure incurred out of that income.

Chapter 3: Qualifying Expenditure

Overview

153. This Chapter supplements the general rules in section 11 with further provisions about qualifying expenditure.

154. Sections 21 to 25 exclude expenditure on the provision of buildings, structures, land and certain other assets from being expenditure on plant or machinery. They define what is and is not a building for this purpose.

155. Section 26 provides for certain costs of demolishing plant or machinery to be treated as expenditure on the provision of plant or machinery.

156. Sections 27 to 33 allow some special types of expenditure to be qualifying expenditure. These are, broadly, expenditure on:

- thermal insulation of industrial buildings;
- fire safety if required by a notice under the relevant legislation;
- safety at sports grounds if required to comply with a certificate under the relevant legislation; and
- personal security if there is a special threat to an individual's security arising from their work.

157. Sections 34 to 38 exclude or restrict some special types of expenditure. These are, broadly, expenditure on:

- accommodation by MPs and some others;
- plant or machinery for a dwelling-house for certain qualifying activities;
- plant or machinery by employees which is not necessary for the performance of their duties;
- plant or machinery if the depreciation is met in full by subsidies; and
- production animals subject to a "herd basis" election (see Schedule 5 to ICTA).

158. Other provisions in this Part also treat expenditure as being expenditure on plant or machinery. See in particular Chapter 7 (computer software) and Chapter 18 (additional VAT liabilities and rebates).

Section 21: Buildings

159. This section is based on paragraphs 1(1), (2) and 5(1) of Schedule AA1 to CAA 1990. It brings together the material excluding buildings from being plant or machinery.

160. *Subsection (1)* sets out the general rule that buildings are not plant or machinery.

161. *Subsection (2)* is based on paragraph 5(2) of Schedule AA1 to CAA 1990. It provides that references to the provision of a building include the construction or acquisition of a building.

162. *Subsection (3)(a)*, *(b)* and *(c)* treats assets incorporated in or connected with a building as part of the building and list A provides a list of assets treated as buildings, whether or not they would otherwise be so.

163. *Subsection (4)* provides a cross-reference to the list of expenditure unaffected by this section in section 23.

164. Chapter 14 provides rules under which allowances can be claimed for fixtures which are assets incorporated in buildings and which in law become part of the building. An asset cannot qualify under Chapter 14 as a fixture unless it is plant or machinery in the first place (see section 172). As the fixture is part of a building, section 25 means that it cannot be plant or machinery unless it comes within the exceptions in section 23.

Section 22: Structures, assets and works

165. This section is based on paragraphs 2 and 5 of Schedule AA1 to CAA 1990. It brings together material excluding structures from the meaning of plant or machinery.

166. *Subsection (1)* sets out the general exclusion of structures, and incorporates list B. The assets in list B are excluded as structures whether or not they are structures in an ordinary sense.

167. *Subsection (2)* incorporates the rule in paragraph 5(1) of Schedule AA1 to CAA 1990 that the cost of construction or acquisition is part of the cost of the structure.

168. *Subsection (3)(a)* is based on paragraph 5(1)(a) and defines “structure”. *Subsection 3(b)* brings in the definition of land from paragraph 5(3). This is needed in subsection (1)(b).

Section 23: Expenditure unaffected by sections 21 and 22

169. This section is based on column 2 of Table 1 in paragraph 1, column 2 of Table 2 in paragraph 2 and paragraph 1(3) of Schedule AA1 together with ESC B50. It also makes two minor changes.

170. The various types of expenditure detailed in this section may be plant or machinery even if they are buildings or structures covered by sections 21 and 22 (which stop buildings and structures being plant).

171. *Subsection (1)* says that sections 21 and 22 do not apply to expenditure in subsection (2).

172. *Subsection (2)* gives a list of other provisions which treat particular items of expenditure as plant.

173. *Subsection (3)* says that the items in list C are unaffected by sections 21 and 22.

174. *Subsection (4)* includes list C. This is made up from column 2 from both Table 1 and Table 2 of Schedule AA1 to CAA 1990. It also includes the items in paragraph 1(3).

175. The merger of the columns involves a minor change. In Schedule AA1 the columns apply differently:

- whether a *building* is plant is unaffected by the Schedule for assets in column 2 of Table 1; and
- whether a *structure* is plant is unaffected by the Schedule for assets which are within either column 2 of Table 1 or column 2 of Table 2 (paragraph 2(3) of Schedule AA1 provides this rule).

176. Merging the Tables in this Act in principle increases the range of expenditure on buildings which is unaffected by the exclusion of buildings from the definition of plant. See *Change 2* in Annex 1.

177. Item 17 of list C is based on paragraph 5(2) of Schedule AA1 to CAA 1990. It adds expenditure on glasshouses to the list of unaffected expenditure instead of having it as a separate exclusion at the end of the Chapter.

178. *Subsection (5)* incorporates the extended meaning of "caravan" from ESC B50. This allows certain things that might not be thought of as caravans to be included as caravans if they are treated as such by section 29(1) of the Caravan Sites and Control of Development Act 1960 or (in Northern Ireland) section 25(1) of the Caravans Act (Northern Ireland) 1963. See *Change 3* in Annex 1.

Section 24: Interests in land

179. This section is based on paragraph 5 of Schedule AA1 to CAA 1990. It provides that expenditure on the acquisition of an interest in land is not expenditure on plant or machinery.

180. *Subsection (1)*states the exclusion and *subsection (2)* qualifies the meaning of "land".

181. *Subsection (3)* links the meaning of "interest in land" with that in section 175.

Section 25: Building alterations connected with installation of plant or machinery

182. This section is based on section 66 of CAA 1990. It allows expenditure on alterations to an existing building to qualify as expenditure on plant or machinery if those alterations are incidental to the installation of plant or machinery.

Section 26: Demolition costs

183. This section is based on section 62 of CAA 1990. It also makes a minor change. It provides that if the plant or machinery is replaced, then the net cost of demolition is added to the expenditure incurred on the new plant or machinery. If it is not replaced, then the net cost of demolition is added to the pool of qualifying expenditure for the chargeable period in which the demolition takes place.

184. The minor change is in the circumstances in which the section applies. Section 62 of CAA 1990 applies only if plant or machinery "is in use" for the qualifying activity when demolished. This section provides relief if "the last use" of the plant or machinery was for the qualifying activity. See *Change 4* in Annex 1.

185. The net cost of demolition is the cost less any money received for the remains.

Section 27: Application of Part to thermal insulation, safety measures, etc.

186. This section is based on parts of sections 69 to 71 of CAA 1990. It provides for expenditure of the types defined in sections 28 to 33 to be qualifying expenditure. It does so by treating the expenditure as meeting the general conditions for plant and machinery allowances. Then the subsequent provisions of this Part apply without additional provisions to cater only for these relatively rare types of expenditure.

187. *Subsection (1)(b)* means these provisions do not apply if an allowance under this Part or a deduction in respect of the expenditure could be made. This differs from CAA 1990 in two respects:

- in section 67 of CAA 1990 there is no such exclusion for thermal insulation; and
- in sections 69 and 70 of CAA 1990 (fire safety and safety at sports grounds) the exclusion goes wider so as to deny plant and machinery allowances if capital allowances can be claimed under any other Part.

188. These differences are largely due to the way the legislation has been revised over the past 25 years with some consequential changes missed. This Act provides a consistent

basis for all these types of expenditure by making minor changes. See *Change 5* in Annex 1.

189. Subsection (1) incorporates the effect of section 161(3) of CAA 1990 in this section. See *Note 74* in Annex 2.

Section 28: Thermal insulation of industrial buildings

190. This section is based on section 67 of CAA 1990. It deals with expenditure incurred on thermal insulation of industrial buildings.

Section 29: Fire safety

191. This section is based mainly on section 69 of CAA 1990. It deals with expenditure on fire safety.

192. *Subsection (4)* uses somewhat different language from CAA 1990. Since this relief was first introduced, the relevant fire safety legislation has been amended. This section adopts the language from the amended legislation. See *Note 10* in Annex 2.

193. *Subsections (5)* and *(6)* are based on ESC B16 which extends the scope of section 69 to include fire precautions taken under Northern Ireland legislation. See *Change 6* in Annex 1.

Section 30: Safety at designated sports grounds

194. This section is based on section 70 of CAA 1990. It deals with expenditure to meet required safety precautions under the Safety of Sports Grounds Act 1975.

Section 31: Safety at regulated stands at sports grounds

195. This section is based on section 70 of CAA 1990. It deals with safety precautions taken under Part III of the Fire Safety and Safety of Places of Sport Act 1987.

Section 32: Safety at other sports grounds

196. This section is based on section 70 of CAA 1990. It deals with safety precautions taken to comply with the Safety of Sports Grounds Act 1975 if a designation order (under section 1 of that Act) is not made but a local authority certifies that the expenditure would fall within a designation order.

Section 33: Personal security

197. This section is based on sections 71 and 72 of CAA 1990. It deals with expenditure to meet a special threat to a person's physical security.

198. The list of relevant qualifying activities for this purpose reflects the extension of the meaning of "trade, profession or vocation" in section 71 of CAA 1990 by sections 28A, 29 and 161(2A) of CAA 1990. See *Note 11* in Annex 2.

Section 34: Expenditure by MPs and others on accommodation

199. This section is based on section 74 of CAA 1990. It deals with certain expenditure by Members of Parliament (and other similar representatives) on accommodation.

Section 35: Expenditure on plant or machinery for use in dwelling-house not qualifying expenditure in certain cases

200. This section is based on sections 28A and 61(2) of CAA 1990. It prevents expenditure incurred in providing plant or machinery in a dwelling house being qualifying expenditure. It applies to Schedule A businesses, overseas property businesses and special leasing.

201. Section 28A(4) of CAA 1990 provides for apportionment if expenditure is incurred on plant or machinery partly for use in a dwelling-house and partly for other purposes. There is no such rule for section 61 (which deals with activities known in this Act as "special leasing"). But section 79 of CAA 1990 provides an equivalent rule for reducing allowances. That has the same effect. See *Note 12* in Annex 2.

Section 36: Restriction on qualifying expenditure in case of employment or office

202. This section is based on section 27(2) of CAA 1990. It adds the "necessarily" condition to the general conditions for plant and machinery allowances in the case of qualifying activities which are employments and offices. This brings the capital allowances requirements into line with other Schedule E reliefs.

Section 37: Exclusion where sums payable in respect of depreciation

203. This section is based on section 80(1) of CAA 1990. It deals with the general exclusion if sums are received to cover all the depreciation of the plant or machinery.

204. The use of "depreciation" is different from CAA 1990 (which refers instead to "wear and tear"). Depreciation is preferred as more familiar. It is also on the face of it a wider term. But in context it is thought to make no difference to entitlement to allowances. See *Note 13* in Annex 2.

Section 38: Production animals etc.

205. This section is based on section 82(2) of CAA 1990. It stops capital allowances being claimed on animals which are subject to the special rules for production animals in Schedule 5 to ICTA (the "herd basis").

Chapter 4: First-year qualifying expenditure

Overview

206. This Chapter defines qualifying expenditure which gives entitlement to first-year allowances (subject to the person owning the plant or machinery in question in the chargeable period the expenditure is incurred – see section 52).

207. Section 39 introduces the three categories of expenditure in chargeable periods covered by the Act which may give rise to first-year allowances.

208. Sections 40 to 43 deal with expenditure which qualifies as incurred for Northern Ireland purposes by small or medium-sized enterprises. The expenditure must be incurred on or before 11 May 2002. They also provide for allowances to be withdrawn in some circumstances if plant or machinery is subsequently used outside Northern Ireland.

209. Section 44 provides for first-year allowances for qualifying expenditure incurred by a small or medium-sized enterprise which is not expenditure on a long-life asset (see Chapter 10).

210. Section 45 provides for first-year allowances for qualifying expenditure incurred on or before 31 March 2003 by a small enterprise on information and communications technology.

211. Section 46 defines expenditure which is excluded from all three categories of first-year qualifying expenditure.

212. Sections 47 to 49 decide whether or not an enterprise is small or medium-sized.

213. Section 50 provides that section 12 does not affect when expenditure is treated as incurred for the purposes of deciding what is and is not first-year qualifying expenditure.

214. Section 51 provides for exchange of information in connection with section 40.

215. Provisions relating to first-year allowances for earlier years are preserved in paragraphs 46 to 51 of Schedule 3 for the purposes of the legislation for additional VAT liabilities.

Section 39: First-year allowances available for certain types of qualifying expenditure only

216. This section is based in part on section 22(1) of CAA 1990. But it is mainly drafted to introduce this Chapter. It sets out the different kinds of first-year qualifying expenditure so readers can see quickly if they are likely to have expenditure which qualifies.

217. The three types of expenditure in this section cover the overwhelming majority of practical circumstances. But a very small minority may also have first-year qualifying expenditure as a result of additional VAT liabilities. See section 236. It is also possible for entitlement to first-year allowances to arise in respect of additional VAT liabilities:

- in a chargeable period to which the Act applies; but
- under the provisions for first-year allowances for expenditure between 1992 and 1993 or between 1997 and 1998.

218. Additional VAT for those periods is likely to be a practical issue for very few people indeed in the chargeable periods covered by the Act. The provisions are only capable of having effect until the end of the period for VAT adjustments (5 or 10 years). So the necessary provisions are in paragraphs 46 to 51 of Schedule 3 to the Act.

Section 40: Expenditure incurred for Northern Ireland purposes by small or medium-sized enterprises

219. This section is based on parts of section 22(3CA) and (3CB) of CAA 1990. It gives the conditions which must be met for first-year qualifying expenditure under this heading.

220. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise.

Sections 41 and 42: Exclusions from section 40

221. These sections are based mainly on section 22(3CC), (3CE), (6D) and (6E) of CAA 1990. They exclude some expenditure from being first-year qualifying expenditure under section 40.

222. *Section 41* gives exclusions according to the nature of the expenditure.

223. *Section 42* excludes plant and machinery intended for use partly outside Northern Ireland if first-year allowances could be a main benefit of the expenditure qualifying.

Section 43: Effect of plant or machinery subsequently being primarily for use outside Northern Ireland

224. This section is based on section 22B of CAA 1990. It stops expenditure being first-year qualifying expenditure under section 40 if there is a change in the use of the plant or machinery and withdraws any first-year allowances which have been made.

225. *Subsection (1)* withdraws entitlement to first-year allowances if plant or machinery is used or held for use primarily outside Northern Ireland in the period defined by subsections (2) and (3). That is five years from the date of the expenditure if it is over £3.5 million and two years if not.

226. *Subsection (4)* allows first-year allowances already made to be withdrawn.

227. *Subsections (5)* and *(6)* require taxpayers to notify the Inland Revenue within three months if, as a result of this section, their tax return needs amendment.

Section 44: Expenditure incurred by small or medium-sized enterprises

228. This section is based on section 22(3D) of CAA 1990. It defines first-year qualifying expenditure for small or medium-sized enterprises.

229. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise for the purpose of subsection (1)(b). Section 90 defines long-life asset expenditure.

Section 45: ICT expenditure incurred by small enterprises

230. This section is based mainly on section 22(3E) to (3H) of CAA 1990. It provides first-year qualifying expenditure for expenditure by small enterprises on information and communications technology (ICT).

231. Sections 47 to 49 decide whether or not expenditure is incurred by a small enterprise for the purpose of subsection (1)(b).

Section 46: General exclusions applying to sections 40, 44 and 45

232. This section brings together legislation in sections 22(6B) and (6C), 38, 50 and 81 of CAA 1990. These are general exclusions which stop expenditure being first-year qualifying expenditure.

233. The exclusions mostly relate to the type of plant or machinery bought or its use. Two which do not are worth noting:

- General exclusion 1 excludes from first-year qualifying expenditure any qualifying expenditure in the chargeable period in which there is a permanent discontinuance of a qualifying activity. This expenditure is fully relieved by a balancing allowance (or reduction in balancing charge) for the appropriate pool. Cutting out first-year allowances simplifies the route to tax relief; and
- General exclusion 8 excludes from first-year qualifying expenditure any qualifying expenditure a person is treated as incurring if they bring into use plant or machinery:
  - — previously not used for that qualifying activity; or
  - — received as a gift.

First-year allowances may already have been given for this plant or machinery when it was originally bought. But an exception to this is made for certain pre-trading expenditure on mineral exploration and access if a person is treated as having sold and bought plant or machinery.

234. It might be thought that the reference in general exclusion 7 to a “trade or business” should be to a “qualifying activity or business”. However, in the context of section 22(6C) of CAA 1990 from which this comes, the phrase “trade or business” translates into this Act so as to make neither wider nor narrower the scope of this exclusion. See *Note 14* in Annex 2.

Sections 47 to 49: Expenditure of small or medium-sized enterprises

235. These three sections are based on sections 22A and 22AA of CAA 1990. They set out how to decide if a company or other business is a small or medium-sized enterprise for the purposes of the legislation for first-year qualifying expenditure.

236. *Section 47* deals with expenditure by companies. As in other sections, the reference to the companies legislation avoids duplication in this Act and makes clear the tests are precisely the same. For ease of reference here the Companies Act 1985 provides:

Section 247: Qualification of company as small or medium-sized

"(1) A company qualifies as small or medium-sized in relation to a financial year if the qualifying conditions are met—

(a) in the case of the company's first financial year, in that year, and

(b) in the case of any subsequent financial year, in that year and the preceding year.

(2) A company shall be treated as qualifying as small or medium-sized in relation to a financial year—

(a) if it so qualified in relation to the previous financial year under subsection (1) above or was treated as so qualifying under paragraph (b) below; or

(b) if it was treated as so qualifying in relation to the previous year by virtue of paragraph (a) and the qualifying conditions are met in the year in question.

(3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

Small company	
1 Turnover	Not more than £2.8 million
2 Balance sheet total	Not more than £1.4 million
3 Number of employees	Not more than 50
Medium-sized company	
1 Turnover	Not more than £11.2 million
2 Balance sheet total	Not more than £5.6 million
3 Number of employees	Not more than 250.

237. These limits can be changed by statutory instrument. The last change was in 1992.

238. The same tests are used in the Companies (Northern Ireland) Order 1986.

239. *Subsections (2)(b)* and *(3)(b)* stop companies qualifying as small or medium-sized if they are members of a larger group. See section 49.

240. *Section 48* deals with expenditure by businesses which are not companies. The test is broadly whether the business would be a small or medium-sized company if the qualifying activity were carried on by a company. This is done by looking at whether or not a hypothetical company would be small or medium-sized.

241. *Subsection (2)* applies the section to businesses carried on by individuals and to others that are not companies and so would otherwise not be able to have first-year qualifying expenditure.

242. *Subsection (5)* sets the assumptions for the hypothetical company which is used to decide if the business is small or medium-sized. These include the assumption that every trade, business, profession or vocation carried on by the business is carried on by the business as part of that activity. This is broadly equivalent to the requirement in section 47(2)(b) that a company is not a member of a large group.

243. *Subsections (6)* and *(7)* then use the relevant companies legislation to decide if the hypothetical company is small or medium-sized.

244. *Subsections (8)* and *(9)* decide the relevant companies legislation for this purpose. They make minor changes to make clear whether the Companies Act or the Northern Ireland legislation should be used for this purpose. The difference does not matter in practice as the legislation is very similar. See *Change 7* in Annex 1.

245. *Section 49* decides if a company is a member of a large or medium-sized group for the purposes of section 47.

246. *Subsection (4)* treats as large or medium-sized a company which is not but would be if arrangements which already exist would make it, or a successor to its trade, large or medium-sized.

247. *Subsections (5)* and *(6)* apply the relevant companies legislation.

Section 249(3) Companies Act 1985

"(3) The qualifying conditions are met by a group in a year in which it satisfies two or more of the following requirements—

Small group	
1. Aggregate turnover	Not more than £2.8 million net (or £3.36 million gross)
2. Aggregate balance sheet total	Not more than £1.4 million net (or £1.68 million gross)
3. Aggregate number of employees	Not more than 50
Medium sized group	
1. Aggregate turnover	Not more than £11.2 million net (or £13.44 million gross)
2. Aggregate balance sheet total	Not more than £5.6 million net (or £6.72 million gross)
3. Aggregate number of employees	Not more than 250.

248. These limits can be changed by statutory instrument. The last change was in 1992.

Section 50: Time when expenditure is incurred

249. This section is based on parts of section 22 of CAA 1990. It disregards the legislation which treats expenditure incurred before a qualifying activity starts as incurred in its first chargeable period (see paragraph 120 above). It is the actual date expenditure is incurred which matters for entitlement to first-year allowances.

Section 51: Disclosure of information between UK tax authorities

250. This section is based on section 22C of CAA 1990. It allows information to be exchanged by the Inland Revenue and the Department of Agriculture and Rural Development in Northern Ireland in connection with the administration of first-year allowances for expenditure by small or medium-sized enterprises for Northern Ireland purposes.

Chapter 5: Allowances and charges

Overview

251. This Chapter makes general provision for the calculation of allowances and charges under this Part. Its provisions are subject to adaptations and modifications provided in the following Chapters. They make special provisions for particular types of asset.

252. Section 52 gives the amount of first-year allowance a person is entitled to in a chargeable period if they incur first-year qualifying expenditure and own the plant or machinery. The person may then claim first-year allowances for the whole or part of first-year qualifying expenditure.

253. Sections 53 and 54 require expenditure to be pooled to decide entitlement to allowances or liability to balancing charges. Allowances may be writing-down allowances or balancing allowances. There are single asset pools, class pools and a main pool. Later Chapters define which expenditure must be allocated to a class or single asset pool. Only expenditure which is not allocated to a class or single asset pool is allocated to the main pool. If a person carries on more than one qualifying activity, there are separate pools for each activity.

254. Sections 55 and 56 decide entitlement to an allowance or liability to a charge for each pool for a chargeable period. This depends on the difference between the available qualifying expenditure (AQE) for a pool for the chargeable period and the total of any disposal receipts to be brought into account (TDR):

- if AQE exceeds TDR, the person is entitled to an allowance. The entitlement is to a writing-down allowance except in the final chargeable period of the pool when it is to a balancing allowance. The rate of writing-down allowances is 25% except for long-life assets (6%) and overseas leasing (10%);
- if TDR exceeds AQE, the person is liable to a balancing charge equal to the difference.

255. Sections 57 to 59 give the general rules for AQE and pointers to other provisions which affect it. The general rule is that AQE for a pool is the qualifying expenditure allocated to the pool for the chargeable period (section 58) plus any unrelieved qualifying expenditure brought forward from the previous chargeable period (section 59).

256. Section 60 defines “disposal receipt” and “disposal event”:

- a disposal receipt is the amount of any disposal value a person must bring into account;
- a disposal event is an event of the type which requires a person to bring a disposal value into account.

257. General disposal events and disposal values are listed in section 61; there are others elsewhere.

258. Sections 63 to 65 restrict disposal values in some cases. There is a general limit equal to the qualifying expenditure incurred by the person (or in some cases a connected person). The disposal value is nil for some gifts. It is also nil if no first-year allowance is made and no qualifying expenditure is allocated to a pool (subject to additional conditions if the plant or machinery is acquired from a connected person).

259. Section 65 gives the general rules for when there is a final chargeable period for a pool.

260. Section 66 gives pointers to some other provisions dealing with disposal values.

Section 52: First-year allowances

261. This section is based mainly on section 22(1) of CAA 1990. It gives entitlement to first-year allowances.

262. *Subsection (1)* gives entitlement to first-year allowances if a person both incurs first-year qualifying expenditure in a chargeable period and owns the plant or machinery in that chargeable period.

263. *Subsection (2)* makes clear that any first-year allowance is made for the chargeable period in which the expenditure is incurred.

264. *Subsection (3)* gives the rates of first-year allowances.

265. *Subsection (4)* allows a person to claim first-year allowances for only some (including none) of their first-year qualifying expenditure. This is more direct than section 22(7)

of CAA 1990. That permits a person to require that the amount of the allowance, or aggregate amount of the allowances, be reduced to an amount specified in that claim. The ability to do so helps people who might otherwise face a balancing charge in the same chargeable period. They can then add some or all of the first-year qualifying expenditure to their pool for the current chargeable period (see paragraph 295 below).

266. Section 22(7) of CAA 1990 deals with the aggregate of allowances to keep the sums simple. Section 52 gives people the option of doing that in practice by claiming for the same proportion of all first-year qualifying expenditure or of claiming for different proportions of different items of expenditure.

267. Section 22(7) does not permit a claim for reduced first-year allowances for ships. But section 30(1)(b) of CAA 1990 makes equivalent provision.

268. Section 22(7) and 30(1) require the claim to specify the reduced allowance required. Subsection (4) achieves this more directly by dealing with qualifying expenditure. See *Note 15* in Annex 2.

269. *Subsection (5)* gives signposts to other provisions which may affect first-year allowances.

Example

Assume P:

starts trading as a plumber on 6 April 2002;

prepares accounts to 5 April each year; and

buys during 2002-03 a van for £5,000 and a computer for £1,000 for use wholly and exclusively for business purposes.

P has for the year ending 5 April 2003:

£5,000 first-year qualifying expenditure under section 44 (expenditure incurred by small or medium-sized enterprises) on which P can claim allowances of £5,000 x 40% = £2,000; and

£1,000 first-year qualifying expenditure under section 45 (ICT expenditure incurred by small enterprises) on which P can claim allowances of £1,000 x 100% = £1,000.

But P does not have to claim these first-year allowances. If, for example, P has income only £1,000 greater than the personal allowance then P might decide to claim first-year allowances of £1,000 in respect of only half the expenditure on the van and none in respect of the expenditure on the computer.

Section 53: Pooling of qualifying expenditure

270. This section makes explicit that qualifying expenditure must be pooled to arrive at writing-down allowances and balancing allowances or balancing charges.

271. As noted in paragraph 98 above, Part II of CAA 1990 does not refer to pools as such. Expenditure is pooled by requiring it to be aggregated for the purposes of working out writing-down allowances, balancing allowances and charges for each trade, deemed trade or notional trade. In this Act these requirements are expressed in terms of pools for qualifying activities.

272. *Subsection (2)* requires that expenditure for separate qualifying activities must be allocated to separate pools. So a person carrying on several qualifying activities may have several main pools and class pools plus separate sets of single asset pools.

Section 54: The different kinds of pools

273. This section sets out explicitly the different types of pool. In CAA 1990 the class pools and single asset pools are notional trades. The main pool is the default for the actual trade – or the activity treated as a trade.

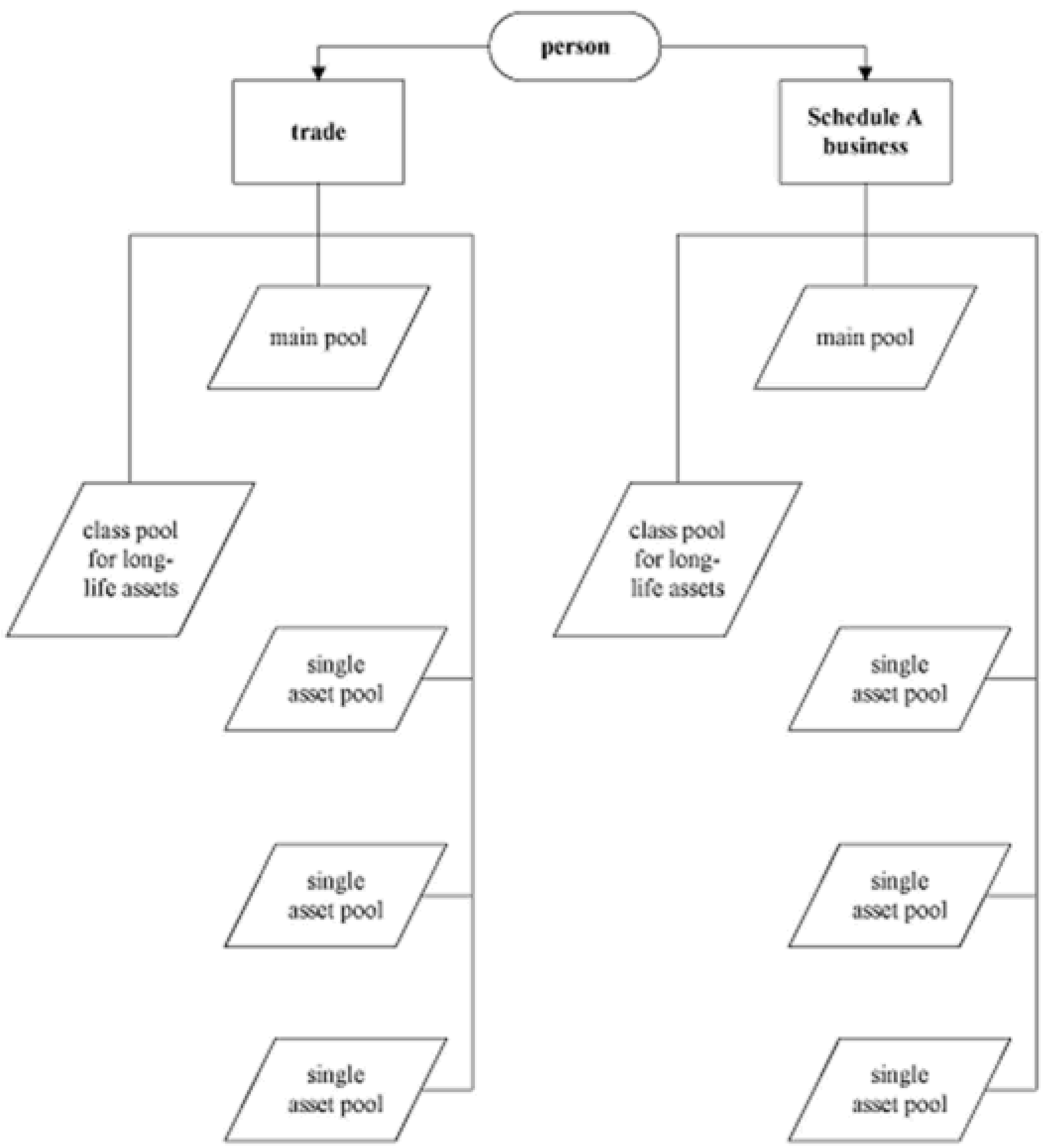
274. *Subsection (2)* provides that a single asset pool cannot contain expenditure in respect of more than one asset. CAA 1990 achieves this by creating a notional trade for expenditure on the provision of an asset separate from any other trade carried on.

275. *Subsection (3)* points to provisions which determine if qualifying expenditure has to be allocated to a single asset pool (if it is allocated to a pool).

276. *Subsection (4)* and *(5)* provide similarly for class pools.

277. *Subsection (6)* provides what is the default rule in CAA 1990. This is that expenditure can only be allocated to the main pool if it does not have to be allocated to a class or single asset pool.

Figure 2: example of requirement that expenditure relating to the different activities must not be allocated to the same pool.



Section 55: Determination of entitlement or liability

278. This section is based on section 24(2) and (5) of CAA 1990. It decides whether a pool gives rise to entitlement to an allowance or liability to a charge.

279. The amounts of available qualifying expenditure (AQE) and total of any disposal receipts (TDR) are not defined until later in this Chapter. But putting this section here lets readers see why they matter:

- if AQE is greater than TDR, they are entitled to claim an allowance; and
- if AQE is less than TDR, they are liable to a balancing charge.

Section 56: Amount of allowances and charges

280. This section is based mainly on section 24(2), (3) and (5) of CAA 1990. It decides the amount of any allowance a person is entitled to claim for a pool or the charge for which they are liable.

281. *Subsections (1)* to *(4)* deal with writing-down allowances. The amount is generally 25% of the excess of AQE over TDR, adjusted up or down if the chargeable period is more or less than a year and/or the qualifying activity is carried on for less than the whole chargeable period. For the class pool for long-life assets the rate is 6%. For the class pool for overseas leasing it is 10%.

282. *Subsection (5)* allows a person to claim less than their full entitlement to a writing-down allowance. Section 24(3) expresses this differently. It requires a person to claim the allowance and to require it to be reduced to a specified amount. But the effect is the same.

283. *Subsection (6)* provides that if TDR is greater than AQE, the balancing charge is the excess: that is TDR-AQE.

284. *Subsection (7)* provides that if:

- AQE is greater than TDR; and
- it is the final chargeable period for a pool,

then the balancing allowance is the excess: that is AQE-TDR.

285. Both a balancing charge and a balancing allowance have the effect, in colloquial terms, of “emptying the pool”.

Section 57: Available qualifying expenditure

286. This section is based on section 25(1) of CAA 1990 which gives the general rule as to what is (in this Act) available qualifying expenditure. But it includes additional pointers to other provisions.

287. *Subsection (1)* gives the general rule. This is that AQE is the sum of:

- qualifying expenditure allocated to the pool in the chargeable period; and
- unrelieved qualifying expenditure brought forward from the pool from the previous chargeable period.

288. *Subsections (2)* to *(4)* point to other provisions which may affect AQE.

Section 58: Initial allocation of qualifying expenditure to pools

289. This section is based in part on section 25 of CAA 1990 and section 118(6) of FA 1994. There are also minor changes in the law. The section sets out the rules for what qualifying expenditure can be allocated to a pool and when.

290. *Subsection (1)* introduces the rules. It leaves implicit that a person is generally free to allocate or not allocate qualifying expenditure to the appropriate pool subject only to the detailed rules. (The "appropriate pool" is defined in subsection (8) as that which this Part requires.)

291. This flexibility over the allocation of qualifying expenditure is a change in the law. On close examination section 25(1) of CAA 1990 requires expenditure to be allocated to a pool in the first chargeable period it can be. This would be the chargeable period it is incurred unless first-year allowances are made. In that case it would be the next chargeable period. However the approach taken in this section is in keeping with the generally prevailing practice and maintains the flexibility taxpayers have had in practice to add qualifying expenditure in a later chargeable period (whether by design or because it was accidentally omitted in an earlier chargeable period). See *Change 8* in Annex 1.

292. *Subsection (2)* prevents qualifying expenditure being used twice.

293. *Subsection (3)* prevents qualifying expenditure being allocated to a pool before it has been incurred.

294. *Subsection (4)* prevents qualifying expenditure being allocated to a pool unless the person owns the plant or machinery at some time in the chargeable period. This is based on section 118(6) of FA 1994.

295. *Subsection (5)* means that:

- qualifying expenditure cannot be allocated to a pool for a chargeable period for which a first-year allowance is made on it – this may be only be part of the qualifying expenditure on the plant or machinery because of section 52(4); but

- the balance of qualifying expenditure less first-year allowances can then be allocated to a pool in any later chargeable period (subject to the other rules such as the person still owning the plant or machinery).

296. This incorporates minor changes in the law which make the legislation more flexible. Again, see *Change 8* in Annex 1. In summary subsection (5):

- drops the requirement in section 25(3) of CAA 1990 that taxpayers must elect by notice to the Inland Revenue if they wish to allocate first-year qualifying expenditure to a pool for the chargeable period they incur it; and

- leaves the balance of qualifying expenditure less first-year allowances made to be allocated to the appropriate pool as and when the taxpayer wishes (subject of course to the other rules).

297. *Subsection (6)* is based on section 25(5). It allows the balance of first-year qualifying expenditure less first-year allowances made to be added to the appropriate pool if there is a disposal event in the same chargeable period. That way the net cost of the plant or machinery is taken into account either by way of first-year allowances or in the pool.

298. It is up to the taxpayer to choose how much of the balance of first-year qualifying expenditure is added to the pool. Normally it will be all of the expenditure. But subsection (6) requires that at least some qualifying expenditure is allocated to the pool; and subsection (7) adds that this may even be a nil amount. This is a necessary corollary to section 64 in which this Act provides that a person does not have to bring a disposal value into account if they have allocated no expenditure to the pool. (Without the rule in subsections (6) and (7), a person might for example buy plant or machinery for £100, sell it for £90 and be left with £100 first-year allowances when the net cost is only £10.) See *Change 8* in Annex 1.

299. Section 220 makes further provision about the allocation of qualifying expenditure in relation to finance leases.

Example

Assume P incurs in 2002-03 first-year qualifying expenditure of:

£5,000 on a van but takes first-year allowances on only £2,500; and

£1,000 on a computer but takes first-year allowances on none of that expenditure. (See example on page 41 above.)

Then P can allocate to the main pool for the plumbing trade for 2002-03:

£2,500 in respect of the van; and

£1,000 in respect of the computer.

This gives available qualifying expenditure of £3,500 in total. P is entitled to claim allowances on this at 25% (see section 56). But P is not required to do so.

Section 59: Unrelieved qualifying expenditure

300. This section is based on parts of sections 24(1) and 25(1) of CAA 1990. It defines the unrelieved qualifying expenditure a person carries forward from a chargeable period.

301. *Subsection (3)* provides that no unrelieved qualifying expenditure can be carried forward from the final chargeable period of a pool. This is implicit in CAA 1990. See *Note 16* in Annex 2.

Example

Assume in the example above that P claims writing-down allowances of £3,500 x 25% = £875.

Then P carries forward £3,500 - £875 = £2,625 unrelieved qualifying expenditure to 2003-04.

P can also allocate to the pool for 2003-04 the balance of the first-year qualifying expenditure on the van on which first-year allowances were claimed (see section 58(5)): £2,500 - £1,000 = £1,500.

So assuming no other expenditure and no disposals P has for 2003-04 available qualifying expenditure (see section 57):

qualifying expenditure allocated to the pool for 2003-04	£1,500
unrelieved qualifying expenditure carried forward	£2,625
	______
available qualifying expenditure	£4,125

Section 60: Meaning of “disposal receipt” and “disposal event”

302. This section is based in part on section 24(6) of CAA 1990. It defines two terms used in this Part.

303. CAA 1990 refers to disposal values. The disposal value there is, broadly, the amount a person may have to bring into account in a pool on the occurrence of various events. But there is no simple term for those events. Nor is the disposal value always the amount actually brought into account. It may for example be limited by section 26(2) of CAA 1990 (see section 62).

304. In the interests of clarity this section defines:

- disposal receipt to mean the amount actually brought into account as a result of a disposal event – the amount which feeds into TDR. The disposal receipt may be less than the disposal value; and
- disposal event to refer to the events of the type which require a disposal value to be brought into account.

305. *Subsection (3)* is based on section 24(6) of CAA 1990. It prevents more than one disposal value being brought into account for the same expenditure on the same plant or machinery in the same pool. This makes clear what has long been the understanding of section 24 of CAA 1990 and the practice. See *Change 9* in Annex 2.

306. However, a person may be required to bring more than one disposal value into account in respect of the same plant or machinery in some circumstances. For example if they buy, sell and buy again the same plant or machinery in one chargeable period there will be two disposal values for the two separate amounts of qualifying expenditure.

307. Similarly there may be disposal values in respect of the same plant or machinery in different pools in the same chargeable period.

Example

A person starts to use plant and machinery partly for non-trade purposes. This requires a disposal value (open market value) to be brought into account. But it also creates a new pool with qualifying expenditure equal to the open market value. (See Chapter 15).

The person then sells the plant or machinery. This requires another disposal value to be brought into account. But that is in the separate, new pool.

Section 61: Disposal events and disposal values

308. This section is based on sections 24(6) and 26(1) of CAA 1990. It gives the general disposal events and the disposal values to go with them.

Example

The assumptions are as in the example for section 59 on page 47 except that P sells the van on 1 March 2004 for £3,000. This is an arm's length sale at market value. The disposal value is £3,000.

For 2003-04 P has:

available qualifying expenditure of £4,125; and

total of any disposal receipts of £3,000;

and, as AQE exceeds TDR, is entitled to writing-down allowances at 25% on £4,125 - £3,000 = £1,125

309. Item 2 in the Table provides for the market value to be found at the time of the sale. CAA 1990 is silent on this. But it is implicit. See *Note 17* in Annex 2.

310. There is a minor change. Item 5 in the Table gives a disposal value which is not in CAA 1990 in relation to the abandonment of certain plant or machinery. Section 24(6)(c)(ii) of CAA 1990 gives this disposal event. But section 26 of CAA 1990 does not give a disposal value for that specific event. In the absence of any specific disposal value within section 26(1), the disposal value is given by section 26(1)(f). It is the open market value of the plant or machinery. This is at odds with the treatment of other plant or machinery when it is demolished or possession is lost; with the treatment of plant or machinery that is dismantled or demolished as part of a decommissioning programme;

and it is uncertain. Item 5 in the Table accordingly provides for the disposal value to be the insurance or other compensation received. See *Change 10* in Annex 1.

Section 62: General limit on amount of disposal value

311. This section is based on section 26(2) and (3) of CAA 1990 with a minor change. It puts a cap on disposal values.

312. *Subsection (1)* is the general rule. It is based on section 26(2) of CAA 1990. The disposal value for any plant or machinery is limited to the qualifying expenditure incurred on it. This is part of the underlying theme of this Part: plant and machinery allowances are given in total for the actual depreciation suffered on the asset. Without this provision someone who (exceptionally) sells plant or machinery for more than they paid for it would end up with an overall charge.

313. *Subsections (2)* and *(3)* modify the general rule concerning plant or machinery acquired from a connected person. They are based on section 26(3) of CAA 1990. They limit the disposal value to the greatest amount of qualifying expenditure incurred by any of those connected persons. This rule goes hand in hand with the provisions in section 61 which allow a person to:

- sell at less than market value to a connected person who can claim capital allowances; and
- bring only the sale proceeds into account as a disposal value (rather than the open market value).

314. Without subsections (2) and (3) people could avoid balancing charges, if allowances exceeded the actual depreciation, by selling to a connected person who then sells the plant or machinery.

315. The rules are expressed in this section in terms of qualifying expenditure. Section 26(2) and (3) of CAA 1990 gives the rule in terms of capital expenditure. This is a change which is in principle generally favourable to taxpayers. It leaves out of account capital expenditure incurred by a connected person who is not carrying on a qualifying activity. It can in theory have a knock-on effect which is against a taxpayer’s interests if the disposal comes within Chapter 17. This is because the benefit for the seller of a lower disposal value may then result in a lower amount of qualifying expenditure for the buyer. See *Change 11* in Annex 1.

316. Section 575 defines a “connected person”.

Section 63: Cases in which disposal value is nil

317. This section is based on parts of sections 24, 67, 69, 70 and 71 of CAA 1990 and of sections 21A, 65A, 70A, 83A and 84 of ICTA. It also makes minor changes. It provides a nil disposal value for a number of disposal events.

318. *Subsection (1)* is based on section 24(6) of CAA 1990. That provides that:

“this subsection shall not require a person to bring into account the disposal value of any machinery or plant which he disposes of by way of gift in such circumstances that there is a charge to tax under Schedule E.

319. This provision has in the past caused some confusion. It was sometimes read as meaning that there was no disposal event at all. That is not right. But the absence of a disposal value still has some odd effects. For example suppose a person buys plant or machinery, claims first-year allowances and then gives it to an employee in the same chargeable period. On the basis of CAA 1990 they would not be entitled to allocate the balance of their qualifying expenditure to a pool. Subsection (1) provides a nil disposal value which allows them to do so. It also makes clearer the effect of the legislation. This could be to the disadvantage of the recipient if the gift were a transaction within Chapter 17

as it prevents the recipient from also claiming allowances. But this is thought to be unlikely in practice. See *Change 12* in Annex 1.

320. *Subsection (2)* makes similar provision for gifts to certain charities, heritage and other bodies, and educational establishments. This is based on parts of sections 83A and 84 of ICTA. They provide that section 24 of CAA 1990 does not require a disposal value to be brought into account. Subsection (2) makes a minor change, as in subsection (1), to provide a nil disposal value with similar effects. See *Change 12* in Annex 1.

321. *Subsection (2)* also omits the requirements in section 84 of ICTA that the person making the gift must have claimed plant and machinery allowances and make a claim for the relief section 84 provides. This is in principle in taxpayers' favour but is very unlikely to make any practical difference. It does however simplify the legislation for gifts to educational establishments and bring it into line with the more modern legislation in section 83A of ICTA which has neither of these requirements. See *Change 13* in Annex 1.

322. *Subsection (3)* lists the qualifying activities which get the benefit of a nil disposal value for gifts within subsection (2). This is based partly on sections 83A and 84 of ICTA. Those sections refer explicitly to trades, professions and vocations. But the effect of other provisions in ICTA is that Schedule A businesses and overseas property businesses are also included. It might be thought that other qualifying activities were also covered for the purposes of plant and machinery allowances. But there is no provision in ICTA which extends sections 83A and 84 to them. See *Note 18* in Annex 2.

323. *Subsection (4)* points to the provisions in ICTA which impose a charge on donors if they or persons connected with them receive any benefit from the gift.

324. *Subsection (5)* provides nil disposal values for expenditure of the types dealt with by section 27. CAA 1990 has the same provisions in sections 67 and 69 to 71.

Section 64: Case in which no disposal value need be brought into account

325. This section is a minor change. It provides that no disposal value need be brought into account in respect of qualifying expenditure if no first-year allowances have been made and no expenditure has been allocated to a pool.

326. There is no explicit provision in CAA 1990 equivalent to this section. It is, however, in line with practice.

327. On the basis that section 25(1) of CAA 1990 requires expenditure to be allocated automatically to a pool, there would be little need for such a provision given that the disposal value is limited to the capital expenditure incurred. But a taxpayer would appear to be required to bring a disposal value into account even if they had not appreciated they had qualifying expenditure and had made no use of it. CAA 1990 also leaves unclear what taxpayers should do if a change in the accepted meaning of plant or machinery results in their having disposal values to bring into account for what they never knew was expenditure on plant or machinery.

328. In practice the Inland Revenue have accepted that expenditure which is not added to the pool, for whatever reason, may be added for a later period provided there has not been a disposal event. This more flexible approach is followed in this Act. The Inland Revenue have also accepted that no disposal value need be brought into account if no first-year allowances have been made and none of the expenditure has been allocated to a pool.

329. Subsection (1) puts this on a clearer statutory basis. It provides that no disposal value need be brought into account if no expenditure is allocated to a pool (which, when read with section 58(6), means also that no first-year allowances are made). See *Change 14* in Annex 1.

330. *Subsections (2)* to *(4)* are consequential on the change in subsection (1). They require a person ("C") who has qualifying expenditure for plant or machinery acquired from a connected person to bring into account a disposal value if:

- C allocates any qualifying expenditure to a pool (or gets first-year allowances); or
- any of the connected persons in the transaction or train of transactions before C brings into account a disposal value.

331. The first is no more than the general rule. The second prevents the minor change in subsection (1) being used by connected persons to escape bringing into account disposal values on plant or machinery for which allowances are claimed. See again *Change 14* in Annex 1.

332. Section 575 defines a "connected person".

Section 65: The final chargeable period

333. This section is based on the several provisions throughout Part II of CAA 1990 which deal with pools. There are also two minor changes. It defines the final chargeable period for pools. A final chargeable period means there may be entitlement to a balancing allowance (see section 56).

334. *Subsection (1)* means there is a final chargeable period for the main pool for the qualifying activity of special leasing when the special leasing ends. This is not clear in section 61 of CAA 1990 but is what one would expect from the underlying approach in Part II of CAA 1990. It avoids anomalies such as a pool with no end; and allowances which cannot be used against any income whatsoever. See *Change 15* in Annex 1.

335. *Subsection (2)* provides a final chargeable period for a single asset pool when there is a disposal event. But this is subject to the additional provisions pointed to in subsection (3). This is based on parts of sections 24, 31, 34, 37, 79 and 80 of CAA 1990. They provide for the notional trades (pools here) to be permanently discontinued. Most use a common form of words:

> "without prejudice to section 24(6)(c)(i) to (iii), the [notional] trade is permanently discontinued when the [plant or machinery] begins to be used wholly or partly for purposes other than those of the actual trade

336. Section 24(6)(c)(i) to (iii) of CAA 1990 lists disposal events and has been taken to mean the pool ends with a final chargeable period when such an event occurs. Subsection (2) provides for this. See *Change 15* in Annex 1.

Section 66: List of provisions outside this Chapter about disposal values

337. This section sets out provisions elsewhere in Part 2 about disposal values.

Chapter 6: Hire-purchase etc. and plant or machinery provided by lessee

Overview

338. This Chapter makes special provision for expenditure on plant or machinery under a hire-purchase or similar contract which a person does not own. It also deals with expenditure by lessees who are required, under the terms of a lease, to provide plant or machinery which they do not own.

339. Section 67 treats a person entitled to the benefit of plant or machinery under a hire-purchase or similar contract as owning it. It also treats the person as having incurred all the expenditure under the contract when they bring the plant or machinery into use.

340. Section 68 provides disposal values when a person ceases to be entitled to the benefit of a contract and so is treated as ceasing to own it. The disposal value depends on whether or not the plant or machinery has been brought into use.

341. Section 69 excludes fixtures (as defined in Chapter 14) from section 67.

342. Section 70 deals with the special circumstances mentioned in paragraph 338. A lessee who is required to provide plant or machinery under the terms of a lease but does not own it is, subject to certain conditions, treated as owning it. The lessor is then, in certain circumstances, subsequently required to bring a disposal value into account.

Background

343. A person buying plant or machinery under a hire-purchase or similar contract does not own it. So they cannot meet the general conditions for allowances under this Part in section 11.

344. Legislation to enable a person to get plant and machinery allowances for expenditure under hire-purchase contracts was introduced (by FA 1957) at the same time as the general rule that plant or machinery had to belong to a person as a result of the expenditure for them to be entitled to plant and machinery allowances.

Section 67: Plant or machinery treated as owned by person entitled to benefit of contract, etc.

345. This section is based mainly on section 60(1) and (4) of CAA 1990. It treats a person who meets the conditions in the section as owning the plant or machinery. This means they meet the general condition in section 11(4)(b) (that the person owns the plant or machinery).

346. *Subsection (3)* treats the person as incurring all the capital expenditure under the contract when the plant or machinery is brought into use for the qualifying activity. *Subsection (4)* treats the person as ceasing to own the plant or machinery when they cease to be entitled to the benefit of the contract if they do not then own it. These have implications for the disposal values given in the next section.

347. This section does not apply to expenditure on fixtures (see section 69) and subsection (3) does not apply to expenditure for finance leasing (see section 229(3)).

Section 68: Disposal value on cessation of notional ownership

348. This section is based on section 60(2) of CAA 1990. It provides the disposal value when a person ceases to be entitled to the benefit of a hire-purchase or similar contract. There is a minor change.

349. Section 60(2) of CAA 1990 makes specific provision for the disposal value when a person ceases to be entitled to the benefit of a contract after bringing the plant or machinery into use for their qualifying activity. *Subsection (2)* gives the amount.

350. CAA 1990 makes no specific provision for the disposal value when a person ceases to be entitled to the benefit of a contract before the plant or machinery is brought into use. *Subsection (3)* fills this gap. The disposal value is the same as in subsection (2) except that, as the person was not treated as having incurred all the remaining capital expenditure under the contract, there is no need to take that amount away as a disposal value. See *Change 16* in Annex 1.

351. *Subsection (5)* refers to section 229. That makes sure the disposal value in subsection (3) here does not disadvantage a person to whom a contract is assigned in a transaction which is within Chapter 17.

Section 69: Hire-purchase etc. and fixtures

352. This section is based on section 60A of CAA 1990. It excludes expenditure on fixtures from the special provisions for hire-purchase and similar contracts in section 67.

Section 70: Plant or machinery provided by lessee

353. This section is based mainly on section 61(4) and (8) of CAA 1990. It provides for the rare circumstances in which a lessee has to provide plant or machinery under the terms of a lease but does not own it. There is a minor change.

354. If the section applies:

- the lessee is treated as owning the plant or machinery; but
- the lessee is not required to bring a disposal value into account when the lease ends.

355. The latter is an exception to the usual rule in CAA 1990 (and in this Act). Usually cessation of ownership (or deemed ownership) is a disposal event. But in the unusual circumstances dealt with by this section it is the lessor who is required, if the plant or machinery continues in use until the lease ends, to bring a disposal value into account. That is certainly the accepted practice. Subsections (3) to (5) provide that. In doing so they fill in some gaps in section 60(4) of CAA 1990. See *Change 17* in Annex 1.

Chapter 7: Computer software

Overview

356. This Chapter makes additional provision for computer software:

- computer software is treated as plant for the purposes of Part 2 (section 71); and
- the grant of rights to software on which qualifying expenditure is incurred may require a disposal value to be brought into account for which there are additional rules (sections 72 and 73).

Section 71: Software and rights to software

357. This section is based on section 67A of CAA 1990. It treats software and rights to software as plant. This means expenditure on software can qualify for plant and machinery allowances.

Section 72: Disposal values

358. This section is based on sections 24(6A) and 26(1)(ea), (eb) and (ec) of CAA 1990. It makes additional provision (over and above those in Chapter 5) for disposal values for computer software.

359. *Subsections (1)* and *(2)* are based on section 24(6A) of CAA 1990. They introduce as an additional disposal event for computer software the grant of a right to use or otherwise deal with software. This does not affect how computer software is subject to the ordinary disposal events. See section 61.

360. *Subsection (3)* is based on section 26(1)(ea), (eb) and (ec) of CAA 1990. It deals with disposal values for the grant of a right to use or otherwise deal with computer software.

Section 73: Limit on disposal values

361. This section is based on section 26(2AA). It deals with the limit on disposal values for computer software and rights to use or otherwise deal in computer software.

362. The general limit on disposal values is in section 62. This section modifies that to take account of the fact that there may have been earlier disposal values brought into account.

Chapter 8: Cars, etc.

Overview

363. This Chapter makes special provisions for cars (and motorbikes) costing over £12,000. It includes definitions which are used for other sections in Part 2.

364. The Chapter:

- requires a single asset pool for expenditure over £12,000 on a car (other than a qualifying hire car) (section 74);
- restricts writing-down allowances to a maximum of £3,000 a year (section 75);
- restricts writing-down allowances further if part of the expenditure is met by another person, the car is use only partly for the qualifying activity, or there is a depreciation subsidy (sections 76 to 78);
- makes additional provision for the disposal value if:
  - — a person ceases to own a car in a transaction within Chapter 17; or
  - — an employee or office-holder has claimed capital allowances for some years and for other years used the administrative fixed profit car scheme instead.

365. Sections 81 and 82 define “car” and “qualifying hire car” for the purposes not just of this Chapter but for Part 2 generally.

Section 74: Single asset pool

366. This section is based on section 34(1) and (2) of CAA 1990. It deals with cars costing in excess of £12,000. Qualifying expenditure on them must be allocated to a single asset pool (if allocated to a pool at all). Section 54 introduces single asset pools.

Section 75: General limit on amount of writing-down allowance

367. This section is based on section 34(3) of CAA 1990. It limits the writing-down allowance on a car above the £12,000 cost threshold to £3,000 a year.

368. *Subsection (3)* lists other provisions of this Chapter that may limit further the amount of the writing-down allowance.

Section 76: Limit where part of expenditure met by another person

369. This section is based on section 34(3)(b) of CAA 1990. It restricts allowances if part of the expenditure on the car is met by another person or persons.

370. The limit of £3,000 on writing-down allowances is restricted further for both the recipient of the contribution and the contributors (if they are entitled to plant and machinery allowances). Each is limited to a proportion of the £3,000 limit according to how much of the expenditure on the car they met. The total writing-down allowances due to all parties cannot exceed £3,000 a year.

371. Subsections (3) and (4), unlike section 35(1) of CAA 1990, do not create special pools for contributions to expenditure on expensive cars. This is not required because of the way Part 11 handles contributions. See *Note 19* in Annex 2, and the related *Change 60* in Annex 1.

Section 77: Car used partly for purposes other than those of qualifying activity

372. This section is based on section 34(5) of CAA 1990. It deals with cars that are partly used for purposes other than those of the qualifying activity.

373. There is no disposal event when a car within this Chapter begins to be used in this way. So the single asset pool under this Chapter takes the place of the single asset pool which would otherwise be required by Chapter 15. But the rules in this section are similar to those in Chapter 15 as regards the just and reasonable reduction to any allowances and charges.

374. Subsection (1) provides that no balancing allowance or charge arises when the car begins to be used partly for purposes other than those of the qualifying activity. See *Note 20* in Annex 2.

375. Subsection (4) deals with calculation of unrelieved qualifying expenditure carried forward. In saying that any reduction of a writing-down allowance under this section is to be disregarded, this subsection goes further than section 34(5) of CAA 1990. See *Note 21* in Annex 2

Section 78: Effects of partial depreciation subsidy

376. This section is based on section 34(5) of CAA 1990. It deals with partial depreciation subsidies made in respect of cars over the cost threshold. Much as with section 77, it takes the place of Chapter 16 for cars, but otherwise has similar effect.

377. Subsection (3) deals with calculation of unrelieved qualifying expenditure carried forward. In saying that any reduction of a writing-down allowance under this section is to be disregarded, it goes further than section 34(5) of CAA 1990. See *Note 21* in Annex 2.

Section 79: Cases where Chapter 17 (anti-avoidance) applies

378. This section is based on section 34(4) of CAA 1990. It deals with cases in which a car is disposed of in a transaction within Chapter 17. The intention when this legislation was introduced was to prevent artificial acceleration of allowances for cars over the cost threshold by disposal events between connected persons.

Section 80: Vehicles provided for purposes of employment or office

379. This section is based on section 27(2A) to (2E) of CAA 1990. It gives plant and machinery allowances to employees and office-holders on a car or cycle they use partly for "business travel". There is a minor change.

380. The general rule in section 36 is that employees and office-holders have qualifying expenditure only for plant or machinery "necessarily provided for use in the performance of the duties". This rule is relaxed to include expenditure on cars and cycles partly for use as in *subsection (2)* – what is generally known as "business use". This includes a minor change to align the legislation for capital allowances with that for expenses in ICTA. See *Change 18* in Annex 1.

381. *Subsection (3)* limits the balancing allowance an employee or office-holder is entitled to if they have:

- in some years claimed capital allowances on a car or cycle; and
- in other years made use instead of the administrative arrangements (for example the fixed profit car scheme) which give tax relief without claims.

Section 81: Extended meaning of "car"

382. This section is based on section 36(1)(a) and (b) of CAA 1990. It defines "car" for the purposes of this Part.

383. Other references to car include sections 46 (general exclusion 2 from first-year qualifying expenditure), 84 (short-life assets treatment ruled out) and 96 (cars are not long-life assets).

Section 82: Qualifying hire cars

384. This section is based on section 36 of CAA 1990. It defines "qualifying hire cars". These are not subject to the provisions of this Chapter.

Chapter 9: Short-life assets

Overview

385. This Chapter provides single asset pools for some expenditure. A person elects for expenditure to be allocated to a pool of this type. Doing so means a disposal event within, broadly, four years gives rise to a balancing allowance (or charge). This gives capital allowances for the net cost of plant or machinery with a life of less than about four years earlier than if the expenditure were allocated to the main pool.

386. Section 83 defines short-life asset and section 84 gives a Table of cases in which treatment as a short-life asset is ruled out.

387. Section 85 deals with the election.

388. Section 86 sets up the single asset pool. Section 87 provides special pooling rules for leased assets.

389. Section 88 prevents avoidance by sale at under value and section 89 deals with the sale of a short-life asset to a connected person.

Section 83: Meaning of "short-life asset"

390. This section is based on section 37(1) of CAA 1990. It introduces the term "short-life asset" and gives its meaning.

Section 84: Cases in which short-life asset treatment is ruled out

391. This section is based on section 38 of CAA 1990. It rules out short-life asset treatment for some types of expenditure on plant or machinery.

Section 85: Election for short-life asset treatment: procedure

392. This section is based on section 37(2) of CAA 1990. It deals with the elections for short-life asset treatment.

Section 86: Short-life asset pool

393. This section is based on section 37(3) and (5) of CAA 1990. It requires single asset pools for short-life assets. It defines the new term "four-year cut-off". This is used in this Chapter only.

Section 87: Short-life assets provided for leasing

394. This section is based on section 37(6) of CAA 1990. It deals with leased assets that are used other than for a qualifying purpose.

395. Section 84 permits assets provided for leasing to be short-life assets if they:

- are cars hired to disabled persons; or
- will be used only for qualifying purposes in the designated period.

396. If the plant or machinery starts to be used for what is not a qualifying purpose, the short-life asset pool ends. The expenditure left in the single asset pool goes to the main pool.

Section 88: Sales at under-value

397. This section is based on section 37(10) of CAA 1990. It provides a general rule that disposals of short-life assets at less than market value have a disposal value of their market value. There are exceptions if the disposal is one in which there is a charge to tax under Schedule E or an election is made under section 89.

Section 89: Disposal to connected person

398. This section is based on section 37(8) and (9) of CAA 1990. It allows connected persons to elect for a different treatment if they transfer a short-life asset between them. They can treat it like a sale at a price equal to the amount of the qualifying expenditure left in the pool. “Connected person” is defined in section 575. Both parties must make the election.

Chapter 10: Long-life assets

Overview

399. This Chapter provides rules for long-life assets. Expenditure on long-life assets must be allocated to a separate class pool. It is subject to a special rate of writing-down allowances of 6%.

400. Section 90 defines “long-life asset expenditure”. Section 91 defines “long-life asset”. Section 92 provides for this Chapter to apply to only part of the capital expenditure on plant or machinery.

401. Sections 93 to 96 provide that some fixtures, ships, railway assets and cars are not long-life assets.

402. Sections 97 to 100 provide, very broadly, that this Chapter does not apply to expenditure on long-life assets up to £100,000. Some types of expenditure are excluded from this.

403. Section 101 requires a class pool for long-life assets unless the expenditure is allocated to a single asset pool.

404. Section 102 limits writing-down allowances for long-life asset expenditure to 6% a year.

405. Sections 103 and 104 provide anti-avoidance rules. Section 103 provides that long-life assets do not cease to be treated as such when they are second-hand. Section 104 prevents avoidance by artificial acceleration of allowances.

Background

406. Legislation for long-life assets was introduced by Schedule 14 to FA 1997. That inserted Chapter IVA of CAA 1990. At the time of the Budget in 1996 it was stated that the intention was to bring the tax treatment of long-life assets more closely into line with normal accountancy practice.

407. The new rules applied only to assets bought under contracts made on or after Budget day in 1996. Section 38H of CAA 1990 provided the necessary legislation to exclude expenditure incurred before 26 November 1996 or expenditure incurred before 1 January 2001 on contracts entered into before 26 November 1996. The effect of section 38H is maintained in paragraph 20 of Schedule 3 to this Act.

Section 90: Long-life asset expenditure

408. This section is based on section 38A(1) of CAA 1990. It defines “long-life asset expenditure”.

Section 91: Meaning of "long-life asset"

409. This section is based on section 38A(2) and (3) of CAA 1990. It defines "long-life asset". A long-life asset is an asset with a useful economic life of 25 years or more when new.

Section 92: Application of Chapter to part of expenditure

410. This section is based on section 38A(4) and (5) of CAA 1990. It deals with circumstances in which this Chapter only applies to part of the capital expenditure on plant or machinery. If that happens then the expenditure within this Chapter is treated as expenditure on a separate asset from the expenditure outside it. If necessary, apportionments are made between that part to which this Chapter applies and that part to which it does not.

Section 93: Fixtures etc.

411. This section is based on section 38B(1) of CAA 1990. It excludes expenditure on fixtures in certain types of building from being long-life asset expenditure.

412. The types of buildings are broadly those which do not usually qualify for industrial buildings allowances. So the long-life asset rules in general only apply to fixtures in industrial buildings.

Section 94: Ships

413. This section is based on section 38B(3) of CAA 1990. It excludes expenditure on ships incurred before 1 January 2011 from being long-life asset expenditure.

414. *Subsection (2)* defines "ship" for these purposes. It covers cruise liners as they are not ships designed primarily for sport or recreation.

415. *Subsection (3)* takes the definitions of "offshore installation" and "controlled waters" from the Mineral Workings (Offshore Installations) Act 1971. The text of these definitions is given in the explanatory note on section 153.

Section 95: Railway assets

416. This section is based on section 38B(4) of CAA 1990. It excludes expenditure on railway assets incurred before 1 January 2011 and used for a railway business from being long-life asset expenditure.

417. *Subsections (2)* and *(3)* define "railway asset" and "railway business".

418. *Subsection (4)* extends the exemption to trains used to travel between the UK and another country.

419. *Subsections (5)* gives "railway" the same meaning as in section 81(2) of the Railways Act 1993. The text of this definition is:

"(2) Where it is stated for the purposes of any provision of this Part that railway has its wider meaning, "railway" shall be taken, for the purposes of that provision, to mean:

a railway;

a tramway; or

a transport system which uses another mode of guided transport but which is not a trolley vehicle system, and cognate expressions shall be construed accordingly.

(3) In paragraphs (a) to (c) of subsection (2) above "guided transport, "railway", "tramway" and "trolley vehicle system" have the meaning given by section 67(1) of the Transport and Works Act 1992.

420. Section 67(1) of the Transport and Works Act 1992 gives the following further definitions:

> ""guided transport system" means transport by vehicles guided by means external to the vehicles (whether or not the vehicles are also capable of being operated in some other way)
>
> "railway" means a system of transport employing parallel rails which-
>
> provide support and guidance for vehicles carried on flanged wheels
>
> form a track which either is of a gauge of at least 350 millimetres or crosses a carriageway (whether or not on the same level)
>
> "tramway" means a system of transport used wholly or mainly for the carriage of passengers and employing parallel rails which-
>
> provide support and guidance for vehicles carried on flanged wheels, and
>
> are laid wholly or mainly along a street or in any other place to which the public has access (including a place to which the public only has access on making a payment)
>
> "trolley vehicle system" means a system of transport by vehicles constructed or adapted for use on roads without rails under electric power transmitted to them by overhead wires (whether or not there is in addition a source of power on board the vehicles).

421. *Subsection (6)* gives other terms the same meaning as in the Railways Act 1993. These definitions are:

> ""goods" includes mail, parcels, animals, plants and any other creature, substance or thing capable of being transported, but does not include passengers;
>
> "light maintenance depot" means any land or other property which is normally used for or in connection with the provision of light maintenance services, whether or not it is also used for other purposes;
>
> "station" means any land or other property which consists of premises used as, or for the purposes of, or otherwise in connection with, a railway passenger station or railway passenger terminal (including any approaches, forecourt, cycle store or car park), whether or not the land or other property is, or the premises are, also used for other purposes;
>
> "track" means any land or other property comprising the permanent way of any railway, taken together with the ballast, sleepers and metals laid thereon, whether or not the land or other property is also used for other purposes; and any reference to track includes a reference to–
>
> any level crossings, bridges, viaducts, tunnels, culverts, retaining walls, or other structures used or to be used for the support of, or otherwise in connection with, track; and
>
> any walls, fences or other structures bounding the railway or bounding an adjacent or adjoining property;

Section 96: Cars

422. This section is based on section 38B(2) of CAA 1990. It excludes expenditure on cars from being long-life asset expenditure.

423. The definition of a car in section 82 means expenditure on cars (and motorbikes) is excluded from this Chapter whether or not the car would be within Chapter 8.

Sections 97 to 100: Monetary limit

424. These four sections are based on sections 38C and 38D of CAA 1990. They provide a *de minimis* limit. Expenditure is not usually long-life asset expenditure if a person's total expenditure on long-life assets is less than £100,000 a year. If the limit is exceeded all the relevant expenditure is long-life asset expenditure.

425. Section 98 means the limit is available to:

- individuals and partnerships within subsections (1) and (2); and
- any company, for the purposes of corporation tax.

426. There is a minor change in section 98(1)(a). It refers to any qualifying activity carried on by an individual. Section 38C(3)(a) of CAA 1990 only refers to trades and professions. See *Change 19* in Annex 1.

427. Section 99 gives the £100,000 limit. It also:

- increases or reduces the limit if a chargeable period is more or less than a year; and
- reduces the limit if a company has associated companies. This reduction is done in the same way that the limit for small companies relief is reduced in section 13 of ICTA.

428. Section 100 sets out when the limit is exceeded. It also provides that all the expenditure on an item of plant or machinery is looked at to see if the limit is exceeded – not just the expenditure which is incurred (or treated as incurred) in a particular chargeable period.

Section 101: Long-life asset pool

429. This section is based on section 38E(1) and (2) of CAA 1990. It requires a separate pool for long-life asset expenditure. If the expenditure does not have to be allocated to a single asset pool this is the class pool for long-life asset expenditure. A separate pool is necessary to apply the 6% rate of writing-down allowances for long-life assets.

430. The rule in section 38E(2)(c) of CAA 1990 which provides that the class pool for long-life assets only ends when the trade ends is in section 65(1).

431. *Subsection (2)* is drafted on the basis that a qualifying activity of special leasing can have a long-life asset pool. See *Note 22* in Annex 2.

Section 102: Writing-down allowances at 6%

432. This section is based on section 38F of CAA 1990. It provides writing-down allowances at 6% a year for long-life asset expenditure. This rate applies to the class pool for long-life assets and to any long-life asset expenditure in a single asset pool.

433. *Subsection (2)* is drafted on the basis that a qualifying activity of special leasing can have a long-life asset pool. See *Note 22* in Annex 2. The 6% rate can also apply to a contributor's single asset pool. See *Note 23* in Annex 2.

Section 103: Later claims

434. This section is based on section 38F(3) and (4) of CAA 1990. It provides that plant or machinery which has been treated as a long-life asset by one person must be treated as a long-life asset by anyone who subsequently incurs qualifying expenditure on it. This broadly means second-hand assets are treated in the same way as they were when new.

435. There is an exception to this. This applies for expenditure that is excluded from being long-life asset expenditure simply by sections 93 to 96. For example, an asset could be a railway asset to a new owner but not the former owner. In such a situation, the new owner's expenditure would be long-life asset expenditure.

Section 104: Disposal value of long-life assets

436. This section is based on section 38G of CAA 1990. It prevents tax avoidance arrangements designed to accelerate allowances.

437. Subsection (1)(d) refers to "tax advantage". This is defined in section 577(4).

438. Subsection (3) deals with the "notional written-down value". This is handled in a different way from section 38G(2) and (3). See *Note 24* in Annex 2.

Chapter 11: Overseas leasing

Overview

439. This Chapter reduces or prohibits allowances on qualifying expenditure if:

- the plant or machinery is leased during the designated period to a person who is not resident in the UK;
- that person does not use the plant or machinery exclusively for earning profits chargeable to UK tax; and
- the leasing is not protected leasing.

440. This expenditure is referred to in this commentary as "affected qualifying expenditure".

441. Sections 105 and 106 define "leasing", "overseas leasing", "protected leasing" and "designated period".

442. Section 107 allocates affected qualifying expenditure to a class pool (the overseas leasing pool) unless it is long-life asset expenditure or expenditure which must be put into a single asset pool.

443. Section 108 modifies the general rules for disposal values if plant or machinery in the overseas leasing pool is disposed of to a connected person. In those circumstances the section also affects the expenditure that the person acquiring the plant or machinery is treated as incurring.

444. Section 109 provides writing-down allowances at 10% a year (instead of 25%) for pools containing affected qualifying expenditure (other than long-life asset expenditure). So this rate applies both to the overseas leasing pool and to any single asset pools containing such expenditure.

445. Section 110 prohibits allowances on affected qualifying expenditure if the plant or machinery is leased under certain types of lease.

446. Sections 111 to 113 recover any excess allowances from earlier chargeable periods if it only becomes clear in a later chargeable period that the expenditure is affected qualifying expenditure. The amount recovered broadly leaves taxpayers where they would have been if allowances had always been given at 10% on the affected qualifying expenditure. There are special provisions to do this for ships.

447. Sections 114 to 115 recover any excess allowances made for earlier chargeable periods if, in a later chargeable period, circumstances are such that allowances are prohibited. The amount recovered again broadly puts taxpayers back where they would have been if allowances had been prohibited from the start.

448. Sections 116 and 117 provide for certain modifications to these rules if the plant or machinery is let to joint lessees.

449. Sections 118 to 120 deal with certificates and notices that are required in certain cases. Sections 121 to 126 define some terms used in this Chapter.

Background

450. The material in this Chapter is based on Chapter V of Part II of CAA 1990.

451. Sections 45, 47 and 49 of CAA 1990 (together with sections 39(2)(a) and (8)(a), 40(4)(a) and (4)(b)(ii)) deal with "old expenditure". They are not rewritten in this Act. See *Note 77* in Annex 1.

Section 105: "Leasing", "overseas leasing" etc.

452. This section is based on sections 42(1), 50(1) to (3A) and 83(2A) of CAA 1990. It defines some of the main terms used in this Chapter.

453. *Subsection (1)(a)* refers to a "ship or aircraft on charter" whereas section 50(2) of CAA 1990 refers to a "ship on charter". This does not affect the law. See *Note 25* in Annex 2.

454. *Subsection (3)(a)'s* reference to "profits chargeable to tax" uses a different form of words from that in sections 42(1)(b) and 50(3A) of CAA 1990. This does not affect the law. See *Note 26* in Annex 2.

Section 106: The designated period

455. This section is based on sections 40(4) and (5) and 50(3) of CAA 1990. It defines the period during which this Chapter can affect qualifying expenditure. Typically that period ends when the person who incurs qualifying expenditure disposes of the plant or machinery or, if earlier, ten years after the person first uses the plant or machinery. But the rules are modified in special cases: for example, if plant or machinery is transferred between connected persons.

Section 107: The overseas leasing pool

456. This section is based on section 41(1)(a) and (6) and part of section 41(2) of CAA 1990. It requires certain affected qualifying expenditure to be put in a class pool ("the overseas leasing pool").

457. *Subsection (2)* takes a simpler approach to special leasing than section 42(2)(e) of CAA 1990. It leaves expenditure on plant or machinery for special leasing to be dealt with like expenditure on plant or machinery for other qualifying activities. See *Note 22* in Annex 2.

Section 108: Effect of disposal to connected person on overseas leasing pool

458. This section is based on section 41(5) of CAA 1990. It prevents disposals to a connected person being used to get a balancing allowance in respect of an overseas leasing pool. It does so by modifying the disposal value that has to be brought into account in the overseas leasing pool. The person acquiring the plant or machinery is treated as having incurred expenditure equal to the disposal value so as to get the right answer in terms of total allowances over the period of their combined ownership.

Section 109: Writing-down allowances at 10%

459. This section is based on sections 42(1) and (2) and 24(2)(a)(ii) of CAA 1990. It replaces the usual 25% rate of writing-down allowances by a 10% rate. This 10% rate applies to:

- the overseas leasing pool; and
- any single asset pool if the plant or machinery is used at any time in the designated period for overseas leasing which is not protected leasing (except for long-life assets for which the normal rate for that of 6% still applies).

460. *Subsection (3)* differs in some respects from section 42(2) of CAA 1990. The subsection:

- applies the 10% rate to all single asset pools including those for expenditure on plant or machinery used partly for the purposes of the qualifying activity and partly for other purposes. These pools are not mentioned in section 42(2) of CAA 1990. See *Change 20* in Annex 1;
- does not mention special leasing. Section 42(2)(e) of CAA 1990 needs to provide for the 10% rate to apply to special leasing. But the simpler approach in section 107 (see paragraph 457 above) means the 10% rate does still apply in such cases. See *Note 22* in Annex 2; and
- covers single asset pools generally. This includes single asset pools for contributions. So it is not necessary to mention them explicitly as in section 42(2)(d) of CAA 1990. See *Note 23* in Annex 2.

Section 110: Cases where allowances are prohibited

461. This section is based on section 42(3) of CAA 1990. It prohibits allowances in certain circumstances.

Section 111: Excess allowances: standard recovery mechanism

462. This section is based on section 46(1) to (4) and (8) of CAA 1990. It recovers allowances if:

- expenditure is allocated to a pool with writing-down allowances at 25%; but
- it becomes clear in a later chargeable period that this Chapter applies to that expenditure.

463. The section broadly withdraws the difference between:

- any first-year allowances plus writing-down allowances at 25%; and
- allowances at 10%.

464. It does so by imposing a balancing charge and requiring a disposal value. In broad terms:

- the balancing allowance recovers the excess of allowances made over what would have been made at 10%; and
- the disposal value takes out of the pool the residue of qualifying expenditure in the pool on which future allowances would otherwise be made at 25%.

465. But in the next chargeable period it allocates to an appropriate pool the total of the allowances withdrawn and the expenditure taken out of the original pool. The net effect of this is broadly that the expenditure is still relieved in full but at a slower rate – as it would have been if the 10% rate had applied from the outset.

Section 112: Excess allowances: connected persons

466. This section is based on section 46(5), (6) and (8) of CAA 1990. It makes two modifications to section 111 for transactions between connected persons.

467. The first modification deals with the possibility that a transaction gives rise to a balancing allowance to one of the connected persons. This would not otherwise be taken into account in section 111 which (without this modification) looks only at first-year allowances and normal writing-down allowances. With this modification any balancing allowance is taken into account when withdrawing excess allowances.

468. The second modifies section 111 if a transfer was not subject to what are known as the "step in shoes" provisions for capital allowances. These are provisions such as sections 561 in this Act and section 343 of ICTA (see paragraph 1936 below) which broadly

allow a successor to take on the entitlement to allowances and liability to balancing charges of a predecessor.

469. The modification:

- identifies the expenditure in relation to which section 111 applies. This is necessary as each of the connected parties may have incurred different amounts of expenditure on the plant or machinery. The amount used is that of the first connected person to have taken an allowance in relation to the plant or machinery; then
- provides that later transactions between the connected parties are ignored; and finally
- provides for a just and reasonable adjustment to the formulae in section 111 if a balancing adjustment has been made to any of the connected persons in respect of the plant or machinery.

Section 113: Special provision for ships

470. This section is based on section 46(7) and (8) of CAA 1990. It deals with the case in which expenditure on a ship has been allocated to a single ship pool by section 127.

471. This section gives priority to sections 111 and 112 over the single ship pool provisions. It ends the single ship pool treatment if, during the designated period, the ship is used for overseas leasing which is not protected leasing (see section 132). It adds any postponed allowances in respect of the expenditure, if they have not been taken by the first chargeable period of such overseas leasing, to the same pool as the amount in section 111(3). The postponed allowances cannot be claimed under the single ship provisions from the first chargeable period of such overseas leasing.

Section 114: Prohibited allowances: standard recovery mechanisms

472. This section is based on section 42(4), (5) and (9) of CAA 1990. It deals with the general case in which allowances are taken on expenditure but, in a later chargeable period, it becomes clear that section 110 applies so that no allowances are available in respect of that expenditure.

473. This section broadly withdraws any allowances by means of a balancing charge and a disposal value. The allowance withdrawn takes account of any allowances withdrawn by section 111 so there is no double counting.

474. *Subsection (2)(b)* provides that a disposal value is to be brought into account to remove from the pool the qualifying expenditure on which no allowances can be made. There is no explicit provision for this in CAA 1990. See *Note 27* in Annex 2.

Section 115: Prohibited allowances: connected persons

475. This section is based on section 42(6) and (7) of CAA 1990. It modifies section 114 if there have been transactions between connected parties which have not resulted in "step in shoes" treatment for capital allowances. It is similar to section 112.

Section 116: Mitigation of regime

Section 117: Recovery of allowances in case of joint lessees

476. These sections are based on sections 43 and 44 of CAA 1990. They deal with expenditure on plant or machinery if at some time in the designated period:

- the plant or machinery is leased to joint lessees who use it for the purposes of qualifying activities but not for leasing;

- one of the lessees is not resident in the UK and does not use the plant or machinery exclusively to earn profits chargeable to UK tax; and
- the leasing is not protected leasing.

477. These sections are likely to affect relatively few people. They are broadly meant to cater for unusual cases in which this Chapter might otherwise lead to results not intended.

478. An example might be a letting of machinery to a partnership between a person in the United Kingdom and a person overseas for use in a construction contract carried on by them outside the United Kingdom. If the partnership is on a 50/50 basis the owner of the plant or machinery might get allowances on 50% of the expenditure under the normal rules. The other 50% would be subject to sections 109 (with writing-down allowances at 10%) and 110 (allowances prohibited). The actual split of the expenditure is based on the extent to which it appears that, over a certain period, the profits of the lessees will be chargeable to UK tax. Without these sections the 10% rate of allowances or the prohibition on allowances would apply to the whole of the owner's expenditure.

479. Because the expenditure which is split is in fact on a single item of plant or machinery there are consequential provisions dealing with the corresponding split of disposal values on a disposal of the plant or machinery.

480. These sections only allow part of the expenditure to be treated for the duration of that lease as being on plant or machinery which is not used for overseas leasing. So if the plant or machinery is used at some other time during the designated period for overseas leasing which is not protected leasing the whole of the expenditure will be subject to the 10% rate or the prohibition on allowances and these sections will be of little or no relevance.

481. If:

- the joint lease continues at the end of the designated period; and
- the profits of the joint lessees chargeable to United Kingdom tax are less than originally anticipated,

there is a provision for downwards adjustment of the part of the expenditure subject to the normal provisions.

482. And if at some time during the joint lease none of the lessees uses the plant or machinery to earn profits chargeable to United Kingdom tax, all of the expenditure becomes subject to the 10% rate or the prohibition on allowances.

483. *Section 117(1)* includes the words "the plant or machinery (or as the case may be)" which do not appear towards the end of section 44(2) of CAA 1990. Without these words, section 44(2) is not entirely consistent. See *Note 29* in Annex 2.

484. Section 43(5) of CAA 1990 is not necessary now and has not been rewritten. See *Note 28* in Annex 2.

Sections 118 to 120: Certificate and notices

485. These sections are based on sections 44(2) and 48 of CAA 1990.

Section 121: Meaning of "short-term leasing"

486. This section is based on section 40(1) to (3) of CAA 1990. It defines when plant or machinery is used for short-term leasing.

Section 122: Short-term leasing by buyer, lessee, etc.

487. This section is based on parts of sections 39(1), (3), (4) and (10) and 40(5) of CAA 1990. The common theme is that the plant or machinery is being used for short-term leasing by any of the various persons mentioned in this section. This is the first of five sections dealing with when plant or machinery is used for a qualifying purpose.

Section 123: Ships and aircraft

488. This section is based on section 39(6) to (8) of CAA 1990. It gives additional circumstances in which a ship or aircraft is used for a qualifying purpose.

Section 124: Transport containers

489. This section is based on section 39(9) of CAA 1990. It gives additional circumstances in which a transport container is used for a qualifying purpose.

Section 125: Other qualifying purposes

490. This section is based on sections 39(1), (2), (5) and (10) and 40(5) of CAA 1990. It treats plant or machinery as used for a qualifying purpose when the plant or machinery is used by certain persons otherwise than for leasing.

Section 126: Minor definitions

491. This section is based on section 50(3) to (4A) of CAA 1990.

Chapter 12: Ships

Overview

492. This Chapter contains provisions relating to plant and machinery allowances and balancing charges arising in respect of expenditure on ships. Within the Chapter there are two main sets of provisions. These provide entitlement to:

- postpone first-year and writing-down allowances arising on ships; and
- defer balancing charges arising on the disposal of certain ships.

493. The first set of provisions deals with pooling of expenditure and postponement of allowances. These provisions allow first-year and writing-down allowances to be "stockpiled" and taken in subsequent chargeable periods. In order to achieve this:

- sections 127 to 129 deal with the allocation of expenditure to single asset pools ("single ship pools"), the circumstances in which expenditure on ships must not be allocated to a single ship pool, and an election for expenditure to be allocated to a different pool;
- sections 130 to 131 allow taxpayers to postpone allowances for single ship pools and to take them in future chargeable periods; and
- sections 132 to 133 deal with disposal events in respect of single ship pools.

494. The second set of provisions deal with deferment of balancing charges:

- section 134 introduces the deferment rules;
- sections 135 to 139 set out when, how and how much of a balancing charge can be deferred;
- sections 140 to 145 set out how to attribute new expenditure on ships with deferred balancing charges. They include rules attributing older balancing charges to older

expenditure, the procedure for varying an attribution and the rules which apply if some of the conditions for attribution cease to be met;

- sections 146 to 150 identify what counts as expenditure on new shipping; and
- sections 151 to 154 identify ships which qualify for the deferment rules;
- sections 155 and 156 allow the deferment rules to operate across a change in the person carrying on the qualifying activity and give "connected persons" a special, wider meaning for the purposes of the deferment rules.

495. Sections 157 and 158 provide for the Chapter to be given effect and apply the provisions of ICTA which decide if companies are members of the same group.

Background

496. Legislation which allowed the postponement of plant and machinery allowances on ships was first introduced in FA 1965. Subsequent changes to plant and machinery allowances made similar provision. The current approach stems mainly from FA 1985.

497. The deferment rules were introduced by sections 94 to 98 of FA 1995 to deal with cases in which:

- a balancing charge arises on the disposal of a ship; and
- a replacement ship is not acquired until a subsequent chargeable period.

498. The deferment rules let a person defer the balancing charge if expenditure (equal to or greater than the amount deferred) is incurred on a replacement ship within six years of the disposal.

Section 127: Single ship pool

499. This section is based on parts of section 31(1) and (2) of CAA 1990. It requires expenditure on ships to be allocated to a single asset pool – called a "single ship pool" – subject to the two exceptions in *subsection (2)*.

500. *Subsection (3)* defines the appropriate non-ship pool. This replaces the term "actual trade" which is used in CAA 1990. See *Note 30* in Annex 2.

Section 128: Expenditure which is not to be allocated to single ship pool

501. This section is based on parts of section 31(1) and (11) of CAA 1990. It provides that expenditure must not be allocated to a single ship pool if the ship is provided for leasing unless the ship meets the conditions in *subsection (1)(a)* and *(b)*.

Section 129: Election to use the appropriate non-ship pool

502. This section is based on section 33 of CAA 1990. It allows taxpayers to opt out of the single ship pool rules in respect of any expenditure on ships. It includes a minor change.

503. *Subsection (1)* provides for an election to do this. CAA 1990 requires taxpayers to give notice for this rather than to elect. By requiring an election, this Act gives taxpayers the benefit of section 42 of TMA 1970 and Schedule 18 to FA 1998. See *Change 21* in Annex 1.

504. This section has nothing for the following provisions in section 33 of CAA 1990 which are unnecessary for this Act:

- section 33(1) – see *Notes 32* and *33*in Annex 2;
- section 33(2) – this is unnecessary given the way this Act deals with pools in Chapter 5; and

- section 33(3)(a) – see *Note 31* in Annex 2.

505. Section 577 defines "notice". Section 576 gives the meaning of "Inland Revenue".

Section 130: Notice postponing first-year or writing-down allowance

506. This section is based on sections 30(1) and (1A) and 31(3) and (3A) of CAA 1990. It allows taxpayers to postpone first-year allowances arising on the provision of ships and writing-down allowances for single ship pools.

507. Section 577 defines "notice". Section 576 gives the meaning of "Inland Revenue".

Section 131: Effect of postponement

508. This section is based on sections 30(2) and (4) and 31(4), (5) and (10) of CAA 1990. It deals with the mechanics of postponing an allowance.

509. *Subsection (1)(b)* provides that the postponement of an allowance does not affect the calculation of the available qualifying expenditure in any chargeable period.

510. *Subsections (2)* and *(3)* provide that the total amount postponed may be taken as allowances in subsequent chargeable periods.

511. *Subsection (4)* makes it clear that the total allowances so claimed may not exceed the total amount postponed.

512. *Subsection (5)* makes it clear that any allowances made (but previously postponed) do not affect the calculation of the unrelieved qualifying expenditure in section 59.

513. *Subsection (6)* ensures that any subsequent claim for an allowance that has previously been postponed does not affect the calculation of writing-down allowances in that subsequent chargeable period.

514. *Subsection (7)* provides that postponed allowances (that have not subsequently been taken) are not treated as amounts carried forward for the purposes of section 403ZB(2) of ICTA. Section 31(10) of CAA 1990 also refers to sections 383(5)(d) and 388(7) of ICTA. However, these references were spent following the repeal of section 383 and of part of section 388(7) by FA 1994.

515. Sections 30(5) and 31(6) of CAA 1990 have not been rewritten. See *Note 34* in Annex 2. That also explains the reference in subsection (1)(b) of this section to "the allowance" in place of "the whole allowance" in section 30(2)(b) of CAA 1990.

Section 132: Disposal events and single ship pool

516. This section is based on parts of sections 31(2) and (11), 31(7), 33(5)(b) and 40(4) of CAA 1990. It:

- gives an additional disposal event for single ship pools; and
- provides special rules for any disposal event which occurs.

517. *Subsection (2)* provides the special rules dealing with all disposal events in relation to a single ship pool. These rules are necessary as the postponement rules are not intended to give rise to balancing allowances or charges on the disposal of a ship.

518. In CAA 1990, a disposal value is brought into account in the notional trade (which is how the single ship pool is established). However, any balancing allowance or charge is not given effect in the normal way. The amount is instead allocated to the shipowner's actual trade as if it were qualifying expenditure (in the sense used in CAA 1990) or a disposal value. This section is more direct. If there is a disposal event in respect of a single ship pool, any available qualifying expenditure is allocated to the appropriate

non-ship pool. It is in that pool that any disposal value is brought into account. The end result under these two different methods is the same. See *Note 35* in Annex 2.

519. *Subsection (3)* makes it clear that a disposal event is dealt with in the same way if there has been an election under section 129.

520. There is nothing in this section equivalent to section 31(8) of CAA 1990. That cannot affect tax liabilities in chargeable periods covered by this Act.

Section 133: Ship not used

521. This section is based on section 32(1) of CAA 1990. It withdraws any writing-down allowances made or postponed for a single ship pool if the ship ceases to be owned without being used for the purposes of the qualifying activity.

522. Relief for expenditure on the ship is not lost. Subsection (3) allocates an amount equal to the withdrawn allowances to the appropriate non-ship pool.

523. *Subsection (4)* makes it clear that this section does not apply as an alternative to section 132. Both sections could apply to a single event.

524. Section 32(2) of CAA 1990 is not rewritten in this Act as it merely ensures that definitions applying in section 31 also apply to section 32(1).

Section 134: Deferment of balancing charges: introduction

525. This section provides an introduction to the deferment rules in sections 135 to 156.

Sections 135 and 136: Claims and conditions for deferment

526. These sections are based on parts of sections 33A(1) and (2) and 33F(1) and (2). They provide the conditions that need to be met if a person is to defer a balancing charge.

527. This Act has nothing corresponding to:

- section 33F(3) of CAA 1990. That provides for claims to be made under the deferment rules on or after 31 May 1996; and
- section 33A(2)(b) of CAA 1990. That provides that there can be no deferment if any of the limits on the amount deferred is nil. It is unnecessary as the deferment of nil would have no effect.

Section 137: Effect of deferment

528. This section is based on part of section 33A(2) of CAA 1990. It provides the mechanism for giving effect to the deferment. It reduces or (if the full balancing charge is deferred) cancels out the effect of the balancing charge by allocating the amount deferred to the appropriate non-ship pool. This is because the balancing charge from the disposal of the ship leads to a disposal value in the appropriate non-ship pool. See paragraph 518 above and section 132.

Section 138: Limit on amount deferred

529. This section is based on part of section 33A(2), (3) and (6) of CAA 1990. It provides the upper limits on the amount of any balancing charge that may be deferred. There is a minor change.

530. *Subsection (1)(a)* provides that the amount deferred must not exceed the balancing charge which would arise in the appropriate non-ship pool if the claim for deferment had not been made. In CAA 1990, this limit is expressed in terms of what would be the balancing charge for the shipowner’s actual trade ignoring balancing charges from the notional trades (in this Act, pools) provided by sections 41(2), 79(5) and 80(5).

531. This subsection is more direct. Subsection (1)(a) also ensures that balancing charges arising in the "appropriate non-ship pool" applicable to a ship may not affect a claim to defer a balancing charge arising in a different pool. See *Change 22* in Annex 1.

532. *Subsection (1)(b)* provides that the deferred amount is limited to the balancing charge actually attributable to the ship. This amount is quantified in section 139. This ensures that other disposal events in the appropriate non-ship pool do not have the effect of increasing the amount available for deferment.

533. *Subsection (1)(c)* ensures that the amount of a deferment claim is limited to the expenditure on new shipping that will be incurred in the six years from the disposal event. This expenditure must be incurred either by:

- the shipowner; or
- if the shipowner is a company, a member of the same group as the shipowner.

534. *Subsection (1)(d)* provides that the amount of the deferment may not exceed the shipowner's profits or income from the qualifying activity in the relevant chargeable period. This ensures that a deferment claim may not create a loss for the chargeable period in which the balancing charge arises.

535. *Subsection (2)* provides that for the purposes of subsection (1)(d):

- other deferments for the chargeable period are taken into account; and
- a deferment takes precedence over the provisions dealing with the carry-forward of trading losses.

Example

Suppose P has a shipping trade. During the year ending 30 June 2001 P has a taxable profit of £340,000. That figure includes a balancing charge of £500,000 arising on the disposal of a qualifying ship. P also has trading losses of £209,000 available to carry forward at 1 July 2000.

If no claim for deferment is made, P's net profit for the year ending 30 June 2001 is:

Actual profit	£340,000
Less:	
Loss brought forward	£209,000
	________
Taxable profit	£131,000
	________

P would have no further losses available to carry forward to the chargeable period for the year ending 30 June 2002.

If P is expecting to incur further expenditure on new shipping within six years of the disposal, P will be entitled to defer the balancing charge arising in the year ending 30 June 2001.

Under subsection (1)(a) the amount qualifying for deferment may not exceed the balancing charge arising (£500,000). Under subsection (1)(d), the deferred amount must also be no more than P's profit for the year ending 30 June 2001 (£340,000). In accordance with subsection (2), the losses brought forward are ignored for this.

Suppose P defers £340,000. The balancing charge is effectively reduced by this amount, giving rise to a nil profit in the year ending 30 June 2001. P's losses of £209,000 will be carried forward to the year ending 30 June 2002.

Section 139: Amount taken into account in respect of old ship

536. This section is based on section 33B of CAA 1990. It determines the amount of any balancing charge that is deemed to relate to the ship. It is one of the provisions that ensure that a shipowner may only defer a balancing charge arising from the disposal of a qualifying ship.

537. It is relatively easy to identify the balancing charge arising on the disposal of the ship if:

- all of the expenditure on the provision of a ship is allocated to a single ship pool; and
- no expenditure is then allocated from the single ship pool to the appropriate non-ship pool.

It is just the excess of the disposal value over the available qualifying expenditure after any allowances. *Subsection (2)* provides this – "amount A".

538. The same cannot be done if some or all of the expenditure on the ship is allocated to the appropriate non-ship pool. It is in the nature of pooling that it is impossible to say how much of any allowance relates to one bit of expenditure and how much to another. Some assumptions have to be made. *Subsections (3)* and *(4)* do this. They provide "amount B" – what would have been the balancing charge if:

- all the expenditure on the ship were allocated to the appropriate pool;
- no other expenditure had been allocated to that pool; and
- writing-down allowances had been made in full.

539. *Subsection (5)* caters for a person who defers a balancing charge and then later makes an election to allocate expenditure to the non-ship pool. They can do this because section 129 allows up to two years to make the election. It substitutes amount B in place of amount A. Any adjustments to assessments can then be made if necessary (see section 157).

Section 140: Notice attributing deferred amounts to new expenditure

540. This section is based on section 33A(5), (5A), (6) and (8) of CAA 1990. It provides the basic conditions that need to be met for a deferred amount to be attributed to expenditure on new shipping.

541. If a deferred amount is not attributed to expenditure on new shipping, then section 144 provides that it ceases to qualify for deferment.

542. *Subsection (1)* provides that the shipowner must give a notice to the Inland Revenue attributing a deferred amount to the new expenditure.

543. *Subsection (2)* makes it clear that an attribution matches a deferred amount with an equal amount of new expenditure.

544. *Subsection (3)* ensures that the rule in subsection (1) is subject to the following two subsections and to the "first-in first-out" rule in section 141.

545. *Subsection (4)* requires the expenditure to be incurred in the six years beginning with the relevant disposal event. For example, if the balancing charge arising relates to the disposal of a ship on 29 November 2001, the expenditure on new shipping must be incurred by 28 November 2007. The expenditure must be incurred by the shipowner or a company within the same group.

546. *Subsection (5)* ensures that the total attributed to new expenditure may not exceed the amount of the new expenditure.

547. Section 577 defines “notice”.

Section 141: Deferred amounts attributed to earlier expenditure first

548. This section is based on section 33D(6) of CAA 1990. It requires a deferred amount to be attributed to the first item of expenditure on new shipping that is incurred in the six-year period. If the first item of expenditure is less than the deferred amount, then the excess is carried forward to the next item, and so on. This means that shipowners cannot generally choose how to attribute deferred amounts.

549. There is a minor change. *Subsection (2)(b)* goes wider than CAA 1990 by providing for the case in which two ships are disposed of simultaneously. See *Change 23* in Annex 1.

Section 142: Variation of attribution

550. This section is based on section 33F(4) and (4A) of CAA 1990. It lets a shipowner vary an attribution. This gives the shipowner an element of choice as to which ship a deferred amount is attributed. That can be of benefit to taxpayers if two (or more) ships are acquired simultaneously.

Example

A has deferred a balancing charge of £1m arising in respect of the disposal of a ship on 20 August 2001. On 7 October 2002, A acquires two new ships, *S1* and *S2* for £500,000 and £750,000 respectively. A initially attributes £500,000 of the deferred amount to both of the new ships.

On 24 March 2003, A sells *S1* for £500,000. As a result of the original claim for deferment, this sale will give rise to a further balancing charge of £500,000. A does not expect to incur any further expenditure on shipping. As a result, A will not be able to defer any of this amount. However, provided A does so within the time limits provided by this section, A can vary the original attribution to maximise the amount attributed to *S2* (in other words to £750,000 leaving only £250,000 attributed to *S1*).

Section 143: Effect of attribution

551. This section is based on section 33C of CAA 1990. It gives effect to an attribution as a disposal value in the single ship pool.

552. This may seem a roundabout way of doing things. The shipowner has in effect already had tax relief for the expenditure on the new ship against the earlier balancing charge. So it might be thought that all that is needed is to provide that some or all of the expenditure on the new ship is not qualifying expenditure. Although that would adequately reduce future plant and machinery allowances it could also cause problems. For example, when the new ship is sold, section 62 might mean there was no disposal value. The approach here, which in effect:

- lets the shipowner add the expenditure on the new ship to a pool but
- requires a disposal value in the pool,

fits in better with the wider scheme of Part 2.

Section 144: Amounts which cease to be attributable

553. This section is based on section 33A(4) of CAA 1990. It deals with cases in which deferred amounts cease to qualify for deferment. For example, if an amount is deferred, it may become clear (either during the six-year period or at its conclusion) that there will not be sufficient expenditure in the period to which the deferred amount may be

attributed. In such cases the amount qualifying for deferment is retrospectively reduced as appropriate.

Section 145: Requirement to notify where no entitlement to defer amounts

554. This section is based on section 33F(5) and (6) of CAA 1990. It requires the shipowner to notify the Inland Revenue on ceasing to be entitled to a deferment.

555. The shipowner has to notify the Inland Revenue no later than three months from the end of the relevant chargeable period. Failure to do so makes the shipowner liable to a penalty under section 98(5) of TMA 1970.

556. This will almost invariably give rise to a change in the shipowner's taxable profits in earlier chargeable periods. *Subsection (4)* allows assessments to be made outside the normal time limits.

557. Section 33F(5) has as one of its conditions that "a claim for deferment has been made". However, the context makes it clear that the provision is only relevant if a deferment has actually been made (rather than simply claimed). As a result this section refers to an amount having actually been deferred.

558. Section 576 gives the meaning of "Inland Revenue". Section 577 defines "notice".

Section 146: Basic meaning of expenditure on new shipping

559. This section is based on section 33D(1) of CAA 1990. It provides the basic conditions for expenditure to qualify as expenditure on new shipping. Sections 147 to 150 give further rules.

560. *Subsection (3)(a)* requires that the expenditure is incurred wholly and exclusively for the purposes of a qualifying activity carried on by the person incurring the expenditure. This stops expenditure from qualifying if, for example, the ship is used only partly for purposes of the qualifying activity of the person incurring the expenditure.

561. *Subsection (3)(b)* requires that when the expenditure is incurred, it must appear that the ship will be used for a qualifying activity (as a qualifying ship) and will continue to do so for at least three years. This is to prevent the attribution of deferments to ships that are not intended to be used as qualifying ships. Section 33D(1)(a) does not include the words "when the expenditure is incurred". But they are implicit in CAA 1990.

562. *Subsection (3)(c)* requires that the expenditure on the ship is allocated to a single ship pool. This stops expenditure on, for example, some ships for leasing from qualifying for the deferment rules.

Section 147: Exclusions: ship previously owned

563. This is the first of four sections with further conditions for expenditure to qualify for attribution. It is based on section 33D(4) and (5) of CAA 1990. It stops expenditure qualifying for attribution if, broadly speaking, a person, A, buys a ship:

- within six years of previously owning it; or
- which had been owned in that six-year period by a person who is connected with A at any time between:
  - — the disposal event; and
  - — A becoming the owner of the ship.

564. "Connected person" is defined in section 187.

Example

A plc defers a balancing charge arising on the disposal of a ship on 6 February 2003. On 23 April 2005 A plc purchases a qualifying ship, *S*. *S* was owned by A plc's subsidiary company, E Limited between 15 May 2001 and 6 June 2002. At all other times, *S* was owned by unconnected third parties.

Subsection (1)(a) does not prevent A plc from attributing the deferred balancing charge to the expenditure on *S* because the company has not previously owned the ship.

Subsection (1)(b), however, determines that the deferred amount may not be attributed to the expenditure on *S*. This applies because E Limited has owned the ship during the six years before S plc acquired the ship (on 23 April 2005) and A plc is connected with E Limited at a material time (in other words at some time between 6 February 2003 and 23 April 2005).

Section 148: Exclusions: object to secure deferment

565. This section is based on part of section 33D(4) of CAA 1990. It is an anti-avoidance provision which stops expenditure qualifying for attribution if deferment of a balancing charge was the object or one of the main objects of the transaction (or transactions) by which the ship was provided.

Section 149: Exclusions: later events

566. This section is based on section 33D(2) and (3) of CAA 1990. It means expenditure ceases to qualify for attribution if any of the events listed in subsection (1) occurs. This stops expenditure for ships, which only temporarily satisfy the conditions, being attributed to deferred balancing charges.

567. *Subsection (1)(a)* provides that the ship has to be a "qualifying ship" for the first three years after it is first brought into use. This term is defined in sections 151 to 154. The 3-year period stops early if the ship begins to be owned by an unconnected third party. CAA 1990 contains the words "without having been so brought into use". This Act does not as the meaning is covered by the use in *subsection (2)(a)* of the words "first" and "if earlier".

568. *Subsection (1)(b)* requires that the expenditure on the ship is not allocated to the appropriate non-ship pool. This only applies to the expenditure to which a deferred balancing charge is attributed. If the total expenditure on the provision of a ship exceeds the deferred amount, the excess can be allocated to the appropriate non-ship pool.

569. *Subsection (1)(c)* requires that the expenditure is not on a ship for overseas leasing which is not protected leasing.

Section 150: Exclusions where expenditure not incurred by shipowner

570. This section is based on section 33D(2A) and (2B) of CAA 1990. It stops expenditure incurred by a member of the same group of companies qualifying as expenditure on new shipping if the company:

- ceases to own the ship before it is used for its qualifying activity; or
- is required to bring in a disposal value in respect of the ship within the first three years of the ship being used,

unless it is because the ship is lost or irreparably damaged.

571. *Subsection (4)* has the same effect if the company and the shipowner cease to be members of the same group within three years of the ship being used by the company. But any changes in the group are ignored if they happen after the ship is lost or irreparably damaged.

Section 151: Basic meaning of qualifying ship

572. This section is based on section 33E(1) of CAA 1990. It provides the basic conditions for a ship to qualify for the deferment rules. That is:

- for a balancing charge on the ship to be deferred; or
- for expenditure on the ship to be attributed to a deferred charge.

Section 152: Ships under 100 tons

573. This section is based on section 33E(2) of CAA 1990. It relaxes the rule that requires a qualifying ship to have a gross registered tonnage of 100 tons or more. The relaxation applies if the disposal event giving rise to the balancing charge is or results from the total loss of a ship or the irreparable damage to it.

Section 153: Ships which are not qualifying ships

574. This section is based on section 33E(3) and (4) of CAA 1990. It provides that certain kinds of ships are not qualifying ships.

575. *Subsection (1)* excludes from the meaning of "qualifying ship" ships of a kind generally used for sport or recreation. Passenger ships and cruise liners are not treated as falling within this exclusion and may therefore be considered as qualifying ships.

576. *Subsection (3)* gives "offshore installations" and "controlled waters" the same meaning as in the Mineral Workings (Offshore Installations) Act 1971. The relevant definitions are reproduced below.

Regulation 3(1) of the Offshore Installations and Pipeline Works (Management and Administration) Regulations 1995 (SI 1995/738)

"An *offshore installation* is "a structure which is, or is to be, or has been used, while standing or stationed in relevant waters, or on the foreshore or other land intermittently covered with water-

(a) for the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well:

(b) for the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;

(c) for the conveyance of things by means of a pipe; or

(d) mainly for the provision of accommodation for persons who work on or from a structure falling within any if the provisions of this paragraph,

and which is not an excepted structure [under paragraph 2]".

Section 12 of the Mineral Workings (Offshore Installations) Act 1971

"*Controlled waters* are:

"tidal waters and parts of the sea in or adjacent to Great Britain up to the seaward limits of territorial waters; and

any area designated by order under section 1(7) of the Continental Shelf Act 1964".

Section 154: Further registration requirement

577. This section is based on part of section 33E(5) to (9) of CAA 1990. It provides that a qualifying ship must generally be registered on a register of shipping within the British Isles, a British colony or the European Economic Area.

578. This additional registration requirement does not need to be met:

- during the first three months that the ship is used; or
- more than three years after the ship is first used.

579. If the ship is no longer owned by the person incurring expenditure on it (or a connected person) at some time during the 3-year period, then the registration requirement does not need to be met from that time.

Section 155: Change in the persons carrying on the qualifying activity

580. This section is based on sections 33D(7) and 33F(7) of CAA 1990. It allows the deferment rules to operate when a trade is transferred in certain circumstances so a successor to the trade can incur the expenditure on new shipping and attribute it to the predecessor's deferred balancing charge.

581. There is a minor change. The section treats expenditure incurred by successors as that of the shipowner. This goes slightly further than CAA 1990. But in practice the effect is only that a successor to a trade is entitled to give notice of a variation of attribution of expenditure under section 142. See *Change 24* in Annex 1.

582. *Subsection (2)* applies only for the deferment rules. In CAA 1990, section 33D(7) applies for the whole of Part II. But this is in fact not a difference. See *Note 36* in Annex 2.

> The circumstances in which section 113 of ICTA may apply are, very briefly, if there is a change in the persons carrying on a trade, profession or vocation, but at least one person carrying on the activity before the change continues to carry it on afterwards.
>
> The circumstances in which section 343 of ICTA may apply are, again very briefly, if a trade is transferred between companies in common ownership.

Section 156: Connected persons

583. This section is based on section 33D(8) and part of section 33E(8) of CAA 1990. It provides an extended meaning of "connected person" for the purposes of the deferment rules. This caters for the way section 155 allows the deferment rules to operate across the transfer of a trade.

584. Section 33E(8)(a) uses the word "connected" without any specified definition. But from the context it is implicit that the word has the meaning given by section 839 of ICTA.

Section 157: Adjustment of assessments etc.

585. This section is based on sections 30(3) and 31(9) and part of section 33F(6) of CAA 1990. It provides for the making of adjustments to assessments as necessary to give effect to the rules in the Chapter.

Section 158: Members of same group

586. This section is based on sections 33D(2B)(b) and 33E(2)(b) and part of section 33A(8) of CAA 1990. It defines when two companies are "members of the same group".

Chapter 13: Provisions affecting mining and oil industries

Overview

587. This Chapter brings together rules which apply only to the mining and oil industries.

588. Section 159 states the meaning of "mineral extraction trade".

589. Section 160 treats expenditure incurred for mineral exploration and access in connection with a mineral extraction trade as incurred for the purposes of the trade.

590. Section 161 deals with relief for pre-trading expenditure on mineral exploration and access.

591. Section 162 sets up a separate qualifying activity for a ring fence trade.

592. Section 163 defines "abandonment expenditure" for the purposes of the next two sections.

593. Section 164 gives special relief for abandonment expenditure in ring fence trades.

594. Section 165 provides relief for abandonment expenditure in the three years following the cessation of trade.

595. Section 166 is an anti-avoidance provision applying if an interest in an oil field is transferred.

596. Sections 167 to 171 deal with production sharing contracts. Section 167 sets out the general conditions which apply. Section 168 treats expenditure incurred on plant or machinery by a contractor under a production sharing contract as being incurred on plant or machinery. Section 169 provides a similar rule for expenditure incurred by "participators" in production sharing contracts. Section 170 deals with the acquisition of an interest in a production sharing contract by a participator. Section 171 deals with disposal values on the cessation of ownership under subsection (2) of any of the previous three sections.

Background

597. Sections 160 and 161 work together to give relief for pre-trading expenditure on mineral exploration and access. If the expenditure is connected with an existing trade, section 160 will apply. If it is not connected to an existing trade then section 161 will apply.

598. On 7 August 2000 the Inland Revenue announced that the government had agreed to bring forward new legislation to give relief for the re-use of oil rigs, pipelines and other North Sea Oil installations. This is expected to form part of Finance Act 2001 and to become incorporated into this Chapter.

Section 159: Meaning of "mineral extraction trade" etc.

599. This section is based on the defined terms in section 83(1) of CAA 1990. They define "mineral extraction trade" and "mineral exploration and access" by reference to the definitions in Part 5. See section 394(2) for the meaning of "mineral extraction trade" and section 396 for "mineral exploration and access".

Section 160: Expenditure treated as incurred for purposes of mineral extraction trade

600. This section is based on section 83(6) of CAA 1990. It provides for expenditure on the provision of plant or machinery for mineral exploration and access which is connected with a mineral extraction trade to be treated as for the purposes of the trade.

601. This relaxes the ordinary rule in *section 11* that expenditure has to be for the purposes of the qualifying activity.

Section 161: Pre-trading expenditure on mineral exploration and access

602. This section is based on section 63 of CAA 1990. It allows pre-trading expenditure on plant or machinery used for mineral exploration and access to be brought into the pool at cost when the trade commences.

603. There is a minor change in *subsection (4)(a)*. In section 63(1)(a) of CAA 1990 there is no explicit requirement that the expenditure has to be *capital* expenditure on the provision of plant or machinery. See *Change 25* in Annex 1.

604. This section is referred to in section 13(7). This is because this section overrides the general rule for plant and machinery which is used before it is brought into use for a qualifying activity. The general rule in section 13(3) and (4) would operate to bring the plant or machinery into the pool at the lower of cost or market value.

605. R&D allowances (see Part 6) are available for some types of pre-trading expenditure on mineral exploration and access. Oil and gas exploration and appraisal is treated as "research and development" by section 437(2)(b).

Section 162: Ring fence trade a separate qualifying activity

606. This section is based on section 492(1) of ICTA and section 62A(2) of CAA 1990. It creates a separate qualifying activity for ring fenced trades.

Section 163: Meaning of "abandonment expenditure"

607. This section is based on section 62A(1). It introduces and defines the term "abandonment expenditure" for the purposes of sections 164 and 165.

608. Subsection (5) refers to definitions in the Oil Taxation Act 1975 and the Petroleum Act 1998. These are set out below.

Section 12 of OTA 1975 provides:

""oil field" shall be construed in accordance with Schedule 1 to this Act.

Schedule 1 to OTA 1975 provides:

" for the purposes of this Part of this Act an oil field is any area which the appropriate authority may determine to be an oil field, being an area of which every part is, or is part of, a licensed area.

Section 29(1) of the Petroleum Act 1998 provides:

" an "abandonment programme" is… a programme setting out the measures proposed to be taken in connection with the abandonment of an offshore installation or submarine pipeline.

Section 44 of the Petroleum Act 1998 provides:

"(1) In this Part of this Act, "offshore installation" means any installation which is or has been maintained, or is intended to be established, for the carrying on of any activity to which subsection (2) applies.

(2) This subsection applies to any activity mentioned in subsection (3) which is carried on from, by means of or on an installation which is maintained in the water, or on the foreshore or other land intermittently covered with water, and is not connected with dry land by a permanent structure providing access at all times and for all purposes.

(3) The activities referred to in subsection (2) are—

(a) the exploitation, or the exploration with a view to exploitation, of mineral resources in or under the shore or bed of relevant waters;

(b) the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;

(c) the conveyance of things by means of a pipe, or system of pipes, constructed or placed on, in or under the shore or bed of relevant waters; and

(d) the provision of accommodation for persons who work on or from an installation which is or has been maintained, or is intended to be established, for the carrying on of an activity falling within paragraph (a), (b) or (c) or this paragraph.

(4) In this Part of this Act, “relevant waters” means—

(a) tidal waters and parts of the sea in or adjacent to the United Kingdom up to the seaward limits of the territorial sea;

(b) waters in an area designated under section 1(7) of the Continental Shelf Act 1964; and

(c) such inland waters as may for the time being be specified for the purposes of this paragraph by Order in Council;

but Her Majesty may by Order in Council provide that, in such cases and subject to such exceptions and modifications as may be prescribed by the Order, this Part of this Act shall have effect as if—

(i) any reference in this Part of this Act to relevant waters included a reference to waters in any area specified under section 10(8); and

(ii) in relation to an installation which is or has been maintained, or is intended to be established, in relevant waters, any reference in subsection (3) to relevant waters included a reference to waters in a foreign sector of the continental shelf which are adjacent to such waters.

(5) For the purposes of this section—

"inland waters” means waters within the United Kingdom other than tidal waters and parts of the sea;

“installation” includes—

(a) any floating structure or device maintained on a station by whatever means; and

(b) in such cases and subject to such exceptions as may be prescribed by Order in Council, any apparatus or works which are by virtue of section 26 to be treated as associated with a pipe or system of pipes for the purposes of Part III of this Act,

but, subject to paragraph (b), does not include any part of a pipeline within the meaning of that section;

“modifications” includes additions, omissions and alterations.

(6) The fact that an installation has been maintained for the carrying on of an activity falling within subsection (3) shall be disregarded for the purposes of this section if, since it was so maintained, the installation—

(a) has been outside relevant waters or, where it was so maintained in a part of a foreign sector of the continental shelf adjacent to those waters, the area consisting of those waters and that part; or

(b) has been maintained for the carrying on of an activity not falling within that subsection.

(7) Any statutory instrument containing an Order under subsection (4) shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Section 45 of the Petroleum Act 1998 provides:

“ “Submarine pipeline” means a pipeline within the meaning of section 26 which is in, under or over waters in the territorial sea adjacent to the United Kingdom; or an area designated under section 1(7) of the Continental Shelf Act 1964.

Section 26 of the Petroleum Act 1998 provides:

"(1) Except where the context otherwise requires, in this Part of this Act "pipeline" means a pipe or system of pipes (excluding a drain or sewer) for the conveyance of any thing, together with any apparatus and works associated with such a pipe or system.

(2) For the purposes of this Part of this Act the apparatus and works associated with such a pipe or system are—

(a) any apparatus for inducing or facilitating the flow of any thing through, or through a part of, the pipe or system;

(b) any apparatus for treating or cooling any thing which is to flow through, or through part of, the pipe or system;

(c) valves, valve chambers and similar works which are annexed to, or incorporated in the course of, the pipe or system;

(d) apparatus for supplying energy for the operation of any apparatus or works mentioned in paragraphs (a) to (c);

(e) apparatus for the transmission of information for the operation of the pipe or system;

(f) apparatus for the cathodic protection of the pipe or system; and

(g) any structure used or to be used solely for the support of a part of the pipe or system.

(3) The Secretary of State may by order provide that a part of a pipeline specified in the order shall be treated for the purposes of this Part of this Act, except this subsection, as a pipeline.

Section 164: Abandonment expenditure incurred before cessation of ring fence trade

609. This section is based on section 62A of CAA 1990. It provides rules for a special allowance for abandonment expenditure.

610. To qualify for the allowance, an election must be made (which is irrevocable).

611. The special allowance is given in the chargeable period of abandonment, effectively as a 100% capital allowance.

612. *Section 165*, provides a similar relief for expenditure in the three years following cessation of the ring fence trade.

Section 165: Abandonment expenditure within 3 years of ceasing ring fence trade

613. This section is based on section 62B of CAA 1990. It deals with abandonment expenditure after the cessation of the ring fence trade.

614. If the ring fence trade has ceased, then the relief provided by section 164 will not be available.

615. There is no election needed but the expenditure must be incurred within three years of the cessation of the ring fence trade. Section 5 determines when capital expenditure is incurred.

616. If the expenditure qualifies then there is no special allowance as such but the additional expenditure is added to the pool for the last period of trading. That will increase the balancing allowance or reduce the balancing charge so the net result is the same.

Section 166: Transfers of interests in oil fields: anti-avoidance

617. This section is based on section 64 of CAA 1990. It provides a rule that prevents the new owner of plant of machinery attributable to an interest in an oil field bringing in as qualifying expenditure more than the cost to the previous owner.

Section 167: Oil production sharing contracts

618. This section and sections 168 to 171 are based on section 64A of CAA 1990. They deal with oil production sharing contracts. In summary:

- a production sharing contract is a contract between an oil enterprise (normally a company) and a government for production of oil to be shared between the company and the government;
- the contractor develops the field under the contract and incurs expenditure on plant and machinery to generate the production;
- the contract provides that the plant and machinery is transferred to the government;
- the contract may be exclusive or there may be other companies involved ("participators");
- the contracts may be transferred; and
- the ordinary plant and machinery rules do not entitle the companies concerned to allowances because they do not own the plant or machinery. Furthermore the transfer itself is a disposal event.

619. This section explains what is meant by a production sharing contract. *Sections 167* to*171* give entitlement to allowances and prevent the transfer being a disposal event.

Section 168: Expenditure on plant or machinery incurred by contractor

620. This section sets out the basic rule for expenditure incurred on plant or machinery by a contractor under a production sharing contract. It allows the expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the contractor.

621. Without this provision contractors would not be entitled to claim capital allowances because the ownership condition in section 11(4)(b) would not be satisfied after the transfer to the government and the transfer itself would be a disposal event.

622. *Subsection (1)* sets out the conditions that need to be satisfied.

623. *Subsection (2)* treats the contractor as owning the plant or machinery until the events identified in paragraph (a) or (b) take place. Section 171 deals with disposal events in those circumstances.

Section 169: Expenditure on plant or machinery incurred by participator

624. This section extends the basic rule in section 168 to include "participators" in production sharing contracts. It allows participators' expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the participator.

625. Without this provision the expenditure would not qualify because the ownership condition in section 11(4)(b) would not be satisfied, and the transfer to the government would be a disposal event.

626. *Subsection (1)* sets out the conditions that need to be satisfied.

627. *Subsection (2)* applies a parallel rule for ownership and cessation of ownership as is provided for contractors in section 168(2). Similarly section 171 deals with disposal events.

Section 170: Participator's expenditure attributable to plant or machinery

628. This section covers the position of participators who acquire an interest in a production sharing contract from a contractor or participator. If:

- part of the expenditure on acquiring the interest is attributable to plant or machinery; and
- that plant or machinery is treated as owned by a contractor or participator under sections 168 or 169,

then this section will allow plant and machinery to qualify for allowances for the participator acquiring the interest.

629. *Subsection (2)* deals with the deemed ownership and says when that comes to an end in a similar way to sections 168(2) and 169(2). Disposal events are given by section 171.

630. *Subsection (3)* creates a disposal event for the person who previously held that interest in the contract, and provides for a disposal value equal to the participators' expenditure. The participator here is the participator in *subsection (1)(a)*. The attributable expenditure is apportioned – see *subsection (6)*.

631. *Subsection (4)* is needed because the participator in this section does not actually incur expenditure on plant or machinery. Instead an interest in a contract has been acquired. This subsection therefore deems the participator to have incurred expenditure and to own it as result of incurring that expenditure. The participator can then claim allowances. In sections 168 and 169 the contractor or participator has actually incurred expenditure on plant or machinery which they own, although it has to be transferred under the contract.

632. *Subsection (5)* deals with the amount of the expenditure that will qualify under this section.

633. *Subsection (6)* provides for a just and reasonable apportionment of the acquisition expenditure to find the amount of expenditure attributable under*subsection (3)*.

Section 171: Disposal values on cessation of ownership

634. This section gives disposal values on cessation of deemed ownership. It applies when the plant or machinery is transferred to the government at the end of the production sharing contract. The disposal events it relates to are in sections 168(2)(a) and (b), 169(2)(a) and (b) and 170(2)(a) and (b). If the contractor or participator receives capital compensation then the disposal value is the amount of that compensation. Otherwise it is nil.

Chapter 14: Fixtures

Overview

635. This Chapter determines entitlement to allowances in respect of capital expenditure on plant and machinery which is or becomes a fixture.

636. Special rules are needed to deal with fixtures since land law treats them as belonging to the owner of the freehold. In many cases, this will mean that the person incurring expenditure on them for use in a qualifying activity will not be the owner of the fixture. In the absence of these rules, many taxpayers incurring capital expenditure on a fixture would fail to qualify for allowances under the general rule in section 11.

637. This Chapter contains six blocks of sections:

- sections 172 to 175 set out the scope of the Chapter and define "fixture" and other terms used in the Chapter;

- sections 176 to 184 determine who is treated as the owner of a fixture and when. The basic rule is that a person who incurs expenditure on a fixture is treated as the owner so long as they have an interest in the relevant land (section 176). Other taxpayers, who may be treated as the owner, are:

  — an equipment lessor (see section 177);

  — a person who buys an interest in the land (see sections 181 and 182); and

  — a lessee (see sections 183 and 184).

It should be noted that sections 193 to 195 also provide for circumstances in which a taxpayer is treated as owning a fixture;

- sections 185 to 187 restrict the amount of qualifying expenditure for plant and machinery allowances in some circumstances. Broadly, these apply if capital allowances have already been claimed in respect of the fixture;
- sections 188 to 192 give disposal events for fixtures in addition to those in Chapter 5;
- sections 193 to 195 provide additional cases in which a taxpayer is treated as owning a fixture. These are listed separately because they are dependent on another taxpayer being treated as ceasing to own the fixture;
- sections 196 to 201 give the disposal values for fixtures. They take the place of the general rules in Chapter 5; and
- sections 202 to 204 deal with interpretation and administrative matters.

Section 172: Scope of Chapter etc.

638. This section is based on parts of sections 51, 52, 53, 54, 55, 56, 56A, 56B, 56C, 57 and 58 of CAA 1990. It defines the scope of the fixtures Chapter.

639. *Subsection (3)* makes clear that the provisions that treat a person as the owner of the fixture are subject to the provisions that treat a person as ceasing to be the owner of the fixture.

640. *Subsection (4)* ensures that references to a person being treated as the owner (or ceasing to be the owner) are references to ownership for the purposes of Part 2.

641. Section 51(1) ensures that if one person is treated as the owner of a fixture then no other person is entitled to an allowance in respect of the fixture. This provision has not been rewritten. See *Change 26* in Annex 1.

Section 173: Meaning of "fixture" and "relevant land"

642. This section is based on section 51(2A) and part of section 51(2) of CAA 1990. It provides a definition of "fixture" and determines what is the "relevant land" for any fixture.

Section 174: Meaning of "equipment lease" and "lease"

643. This section is based on section 53(4) and parts of sections 51(2) and (3) and 53(1) of CAA 1990. It provides definitions for "equipment lease", "equipment lessor", "equipment lessee" and "lease".

644. *Subsection (1)(a)* defines an "equipment lease" as an agreement entered into in the circumstances given in *subsection (2)*. *Subsection (1)(b)* includes the actual lease entered into "under or as a result of such an agreement". Section 53(4) refers to a lease

"entered into pursuant to such an agreement". Although the words used in this Act are simpler, the meaning is the same.

Section 175: Meaning of "interest in land", etc.

645. This section is based on section 51(4) and parts of section 51(2) and (3) of CAA 1990. It provides a definition of "interest in land" for the purposes of the Chapter.

646. *Subsection (2)* is necessary because of Northern Ireland land law. In Northern Ireland, it remains possible for mortgagees to hold an interest in land as security. The interest in land may be conveyed or assigned to them. This subsection ensures that it is the mortgagor (borrower), and not the mortgagee (lender), that is treated as the owner of the interest.

Section 176: Person with interest in relevant land having fixture for purposes of qualifying activity

647. This section is based on part of section 51(1) and (2) of CAA 1990. It provides one of the ways in which a person may be treated as the owner of a fixture.

648. This provision deals with the circumstances in which a person, with an interest in the relevant land, incurs capital expenditure on the provision of plant or machinery and the plant or machinery becomes a fixture. *Subsection (1)* deals with this basic rule.

649. *Subsections (2)* and *(3)* provide tie-breaker rules if two (or more) persons might otherwise be treated as the owner under subsection (1). In *Rule 3*, it is the lesser interest that qualifies.

Example

Suppose R and J would both be treated as the owner of a fixture under subsection (1). The interest in the relevant land held by R is the fee simple estate. J has a leasehold interest in the land.

Provided that Rules 1 and 2 do not apply in respect of any other person, then J (and not R) may be treated as the owner of the fixture because J's interest is not in reversion on the interest held by R.

Section 177: Equipment lessors

650. This section is based on section 53(1A) and on part of section 53 of CAA 1990. The section deals with the cases which allow equipment lessors to be treated as the owner of a fixture.

651. There are three sets of rules that allow equipment lessors to be treated as the owner of a fixture. The conditions that need to be met are in sections 178 to 180. *Subsection (1)* sets out the conditions that need to be met in all three cases.

652. *Subsections (2)* and *(3)* deal with the time from which the equipment lessor may be treated as the owner of the fixture. This is generally the time when the equipment lessor incurs the capital expenditure on the plant or machinery. However, this is modified if the conditions of section 178 are met (and the conditions of sections 179 and 180 are not met). If the equipment lessee does not yet carry on the qualifying activity, then the equipment lessor is not be treated as the owner of the fixture until the time when the equipment lessee begins to carry on the qualifying activity. See *Note 37* in Annex 2.

Section 178: Equipment lessee has qualifying activity etc.

653. This section is based on part of section 53(1) of CAA 1990. It sets out the additional conditions that need to be met for an equipment lessor to be treated as the owner if the plant or machinery is provided for the purposes of the equipment lessee's qualifying activity.

Section 179: Equipment lessor has right to sever fixture that is not part of building

654. This section is based on section 53(1C) and on part of section 53(1B) of CAA 1990. This provision was introduced in FA 1997 to treat lessors of street furniture (for example bus-shelters) as the owner of the fixture. The section contains the additional conditions that need to be met in such cases.

Section 180: Equipment lease is part of affordable warmth programme

655. This section is based on section 53(1E) and (1F) and on part of section 53(1D) and (1G) of CAA 1990. These provisions were introduced in FA 2000 to treat lessors of domestic heating equipment as the owner of the fixture. The section contains the additional conditions that need to be met in such cases.

Section 181: Purchaser of land giving consideration for fixture

656. This section is based on part of sections 54 and 56A of CAA 1990. The section sets out the conditions that need to be met if the purchaser of an interest in the relevant land is to be treated as the owner of the fixture.

657. This section only deals with cases in which a person purchases an existing interest in the relevant land.

658. The basic rule is dealt with in *subsection (1)*. *Subsections (2)* and *(3)* provide that subsection (1) does not apply if another person is treated as the owner of the fixture in respect of a different interest in the relevant land.

Example

L Limited owns the fee simple estate in a building. The company incurs capital expenditure on the provision of a fixture for the purposes of its qualifying activity. Suppose, however, that the company does not make a claim in respect of its expenditure (as defined in section 202).

Suppose also that H Limited has a leasehold interest in the building and that H Limited assigns this interest to N Limited. Provided that N's consideration for the lease includes a capital sum that falls to be treated as expenditure on the provision of the fixture, then N Limited would be treated as the owner of the fixture under this section.

However, if L Limited were to make a claim then subsections (2) and (3) of this section would prevent N Limited from being treated as the owner of the fixture.

Section 182: Purchaser of land discharging obligations of equipment lessee

659. This section is also based on part of sections 54 and 56A of CAA 1990. The section provides an equivalent to the previous section if the fixture was let under an equipment lease. It deals with cases in which the person acquiring the interest in the relevant land pays a capital sum to discharge the obligations of the equipment lessee under the equipment lease.

660. The basic rule is dealt with in *subsection (1)*. *Subsections (2)* and *(3)* provide that subsection (1) does not apply if another person is treated as the owner of the fixture in respect of a different interest in the relevant land.

661. This section does not deal with cases in which the equipment lessor is treated as the owner of the fixture under section 177. Instead, such situations are dealt with in sections 192 and 195.

Section 183: Incoming lessee where lessor entitled to allowances

662. This section is based on section 55 of CAA 1990. It deals with cases in which a lease is granted in the relevant land and the lessor is entitled to an allowance. It also covers cases in which the lessor is not entitled to an allowance simply because the lessor is not within the charge to tax. The section provides when the new lessee may be treated as the owner of a fixture.

663. Because the section effectively transfers deemed ownership from the lessor to the lessee it is necessary for both to make an election for these provisions to apply.

664. One of the conditions for this section to apply is that the lessor is entitled to an allowance in respect of the fixture for the chargeable period in which the lease is granted. CAA 1990 deals with this in section 55(1)(b). However, it includes the words "apart from section 57"; section 57 deals with fixtures treated as ceasing to belong to a person. These words have no effect and have not been rewritten.

Section 184: Incoming lessee where lessor not entitled to allowances

665. This section is based on part of sections 56 and 56A of CAA 1990. It is similar to section 183 but deals cases in which the lessor is not entitled to an allowance (or would not be entitled even if the lessor were within the charge to tax).

666. As the lessor is not giving up ownership in such situations, there is no requirement for an election. However, a restriction applies if another person is treated as the owner of the fixture in respect of a different interest in the relevant land. This is dealt with in *subsections (2)* and *(3)*.

Section 185: Fixture on which a plant and machinery allowance has been claimed

667. This section is based on section 56B of CAA 1990. It restricts the amount of expenditure that may be taken into account if a previous "owner" has claimed a plant and machinery allowance in respect of the fixture.

668. The broad effect of this section is to restrict the amount of future claims to the lowest disposal value brought into account by previous owners. This provision ensures that taxpayers cannot artificially inflate the amount attributed to a fixture on which plant and machinery allowances may be available at the expense of land on which plant and machinery allowances are not available. The limit is known as the "maximum allowable amount".

669. *Subsection (2)(b)* ensures that if excessive expenditure has already been taken into account, then an adjustment should be made.

670. *Subsection (3)* provides that the "maximum allowable amount" may be increased to the extent that any of the new qualifying expenditure falls within section 25.

671. *Subsection (4)* ensures that if more than one disposal event has occurred, then the section only considers the most recent event. *Subsection (5)* makes it clear that a person's qualifying expenditure may be restricted by reference to a disposal value brought into account by the same person in respect of a previous period of ownership.

672. If there is a sale of the plant or machinery as a chattel between unconnected persons, then *subsections (6)* and *(7)* provide that taxpayers may ignore ownership and disposal values in respect of any time before such a sale.

Section 186: Fixture on which an industrial buildings allowance has been made

673. This section is based on section 56C of CAA 1990. It restricts the amount of expenditure that may be taken into account if a person has claimed an industrial buildings allowance in respect of the fixture.

674. There is a general rule in section 9 that a fixture on which an industrial buildings allowance has been claimed may not be subject to a claim for plant and machinery allowances. However, this rule is relaxed if this section applies.

675. If this section applies, the qualifying expenditure is restricted to a proportion of the residue of the expenditure (as defined in section 313). This proportion is the proportion of the consideration that relates to the fixture on the transfer from the former owner.

Section 187: Fixture on which a research and development allowance has been made

676. This section is based on section 56D of CAA 1990. It restricts the amount of expenditure that may be taken into account if a person has claimed a R&D allowance in respect of the fixture.

677. As in the previous section, the rule in section 9 is relaxed if this section applies.

678. If this section applies, the qualifying expenditure is restricted to a proportion relating to the fixture of the Part 6 expenditure (or, if lower, the disposal value brought into account).

Section 188: Cessation of ownership when person ceases to have qualifying interest

679. This section is based on part of section 57(2) to (4) of CAA 1990. It provides that a taxpayer is treated as ceasing to own a fixture when ceasing to have the “qualifying interest”.

Section 189: Identifying the qualifying interest in special cases

680. This section is based on part of section 57(3) of CAA 1990. It provides that in certain circumstances, a person is not treated as ceasing to own a fixture even when ceasing to own the “qualifying interest”.

681. These circumstances broadly apply when the person acquires another interest in the relevant land which replaces the previous “qualifying interest”. In such cases, the new interest becomes the qualifying interest.

Section 190: Cessation of ownership of lessor where section 183 applies

682. This section is based on section 57(5) of CAA 1990. It applies if an incoming lessee begins to be treated as the owner of a fixture under section 183.

683. One of the conditions for section 183 to apply is that the lessor is treated as the owner of the fixture. This section provides that when the lessee begins to be treated as the owner of the fixture, the lessor must be treated as ceasing to be the owner.

Section 191: Cessation of ownership on severance of fixture

684. This section is based on section 57(7) of CAA 1990. It deals with cases in which a fixture is permanently severed from the relevant land.

685. In such cases, the person who was previously treated as owning the fixture is treated as ceasing to own it. However, this does not apply if the person becomes the actual owner of the plant or machinery as a result of the severance.

Section 192: Cessation of ownership of equipment lessor

686. This section is based on part of section 58(1) and (5) of CAA 1990. It provides for cases in which an equipment lessor is to be treated as ceasing to own the fixture.

687. This section applies if either:

- the equipment lessor assigns the rights under the equipment lease; or
- the equipment lessee's financial obligations are discharged.

688. *Subsection (3)* provides that references to "equipment lessee" include any person in whom the financial obligations under the equipment lease may have been vested.

Section 193: Acquisition of ownership by lessor or licensor on termination of lease or licence

689. This section is based on section 57(6) of CAA 1990. It deals with cases in which a person is treated as ceasing to be the owner of a fixture because of the termination of the person's interest in the relevant land under section 188.

690. The section applies if the interest is a lease or a licence. In such cases the lessor (or licensor) under the lease (or licence) is treated as the owner of the fixture from that time.

Section 194: Acquisition of ownership by assignee of equipment lessor

691. This section is based on section 58(3) and part of section 58(2) of CAA 1990. It deals with cases in which, under section 192, an equipment lessor assigns the rights under the equipment lease.

692. This section provides that the assignee is treated as being the owner of the fixture. Further, the assignee is treated as incurring on the provision of the fixture any consideration given for the assignment.

693. *Subsection (2)* provides that the assignee is subsequently treated as an equipment lessor for the purposes of sections 192 and 195 and future operations of *subsection (1)* of this section.

Section 195: Acquisition of ownership by equipment lessee

694. This section is based on part of section 58(4) and (5) of CAA 1990. It provides that an equipment lessee may be treated as being the owner of a fixture. This section applies if:

- in a case dealt with by section 192, it is the equipment lessee who discharges the equipment lessee's financial obligations under the equipment lease; and
- the equipment lessee does so by paying a capital sum.

695. *Subsection (2)* provides that references to "equipment lessee" include any person in whom the financial obligations under the equipment lease may have been vested.

Section 196: Disposal values in relation to fixtures: general

696. This section is based on sections 57(1) and 59 and part of section 58(2), (4) and (5) of CAA 1990. It determines the basic disposal value to be taken into account in different scenarios in respect of a fixture.

697. *Subsection (1)* provides a Table showing the different disposal values depending on the circumstances. Item 2 of the Table refers to a condition that needs to be satisfied. The alternate legs of this condition are in *subsection (2)*.

698. *Subsection (3)* makes it clear that disposals dealt with by item 1 or 5 are subject to an election being made under section 198 or 199.

699. *Subsection (4)* provides that references to "equipment lessee" include any person in whom the financial obligations under the equipment lease may have been vested.

700. *Subsection (5)* makes it clear that a taxpayer may need to bring a disposal value into account under the rules of Chapter 5 because of an event not covered by this Chapter.

701. *Subsection (6)* makes it clear that these disposal values are subject to section 197 which deals with avoidance cases.

702. Section 59(11) of CAA 1990 has been rewritten in paragraph 41 of Schedule 3.

Section 197: Disposal values in avoidance cases

703. This section is based on section 59A(1) to (3) of CAA 1990. It substitutes a "notional written-down value" for the disposal value in avoidance cases.

704. *Subsection (1)(d)* refers to a taxpayer obtaining a "tax advantage". This term is defined in section 577(4).

705. The paragraph also refers to a disposal event which "is part of, or occurs as a result of" a scheme or arrangement. Section 59A(1)(c) of CAA 1990 uses the words "is comprised in, or occurs in pursuance of". The wording in this Act is simpler than that in CAA 1990 without changing its meaning.

706. *Subsection (3)* uses a formula to define the "notional written-down value" in line with the similar provisions elsewhere in this Act. See *Note 24* in Annex 2.

Section 198: Election to apportion sale price on sale of qualifying interest

707. This section is based on part of section 59B(1) to (4) of CAA 1990. It provides that, in certain circumstances, the parties to a transaction may elect to fix a disposal and acquisition value in respect of a fixture.

708. *Subsection (1)* ensures that an election under this section may only apply if the disposal event is one for which item 1 of the Table in section 196 would otherwise apply. (This item applies if there is a sale of the qualifying interest, but item 2 of the Table does not apply.)

709. *Subsection (2)* ensures that the amount fixed by the election is to be used as the disposal value instead of the value determined by item 1. It also ensures that the amount is to be used for other purposes of this Part. In particular, if the purchaser is to claim allowances in respect of the fixture then the election will determine the expenditure treated as incurred. In all cases, this subsection provides that the election must be made jointly by the purchaser and seller.

710. *Subsection (3)* provides two limits for the amount that may be fixed under an election under this provision. The amount may not exceed the actual sale price. It must also not exceed the amount which was treated as incurred by the seller on the provision of the fixture.

711. *Subsection (4)* deals with the attribution of any part of the sale price not attributed to the fixture by the election.

712. *Subsection (5)* provides that an election cannot override a restriction on allowances under section 186 or 187. If appropriate, those sections still apply to limit the purchaser's expenditure that may be brought into account under the rules for plant and machinery allowances.

713. The subsection also ensures that the seller's disposal proceeds may still be substituted by the notional written-down value in avoidance cases (see section 197).

Section 199: Election to apportion capital sum given by lessee on grant of lease

714. This section is also based on part of section 59B(1) to (4). It provides that the parties to a transaction may elect to fix a disposal and acquisition value in respect of a fixture in cases dealt with by item 5 of the Table in section 196.

715. *Subsection (2)* ensures that the amount fixed by the election is to be used as the disposal value instead of the value determined by item 5. It also ensures that the amount is to be used for other purposes of this Part. In particular, if the incoming lessee is to claim allowances in respect of the fixture then the election will determine the expenditure treated as incurred. In all cases, this subsection provides that the election must be made jointly by the lessor and the lessee.

716. *Subsection (3)* provides two limits for the amount that may be fixed under an election under this provision. The amount may not exceed the actual capital sum incurred by the lessee. It must also not exceed the amount which was treated as incurred by the lessor on the provision of the fixture.

717. *Subsection (4)* deals with the attribution of any part of the capital sum not attributed to the fixture by the election.

718. *Subsection (5)* provides that an election cannot override a restriction on allowances under section 186 or 187. If appropriate, those sections still apply to limit the lessee's expenditure that may be brought into account under the rules for plant and machinery allowances.

719. The subsection also ensures that the lessor's disposal proceeds may still be substituted by the notional written-down value in avoidance cases (see section 197).

Section 200: Elections under section 198 and 199: supplementary

720. This section is based on section 59B(5) and 59C(6) and part of section 59C(3) of CAA 1990. It provides additional rules that apply to elections under either of the previous two sections.

721. *Subsection (2)* ensures that an election overrides any apportionment made under sections 562 to 563.

722. *Subsection (4)* provides for cases in which, after an election is made, circumstances arise which have the effect of reducing the maximum amount that may be fixed under the election (under either section 198(3) or 199(3)). If the reduced value is less than the amount specified by the election, then the election is treated as having specified the lower amount.

Example

V acquires from O the fee simple interest in a building on 1 March 2002. On 2 April 2003, V sells this interest to R.

V and R make an election under section 198 and apportion £10,000 to a fixture. Subsequently, but within the two-year limit imposed by section 201(1), V and O enter into an election and apportion £5,000 to the same fixture.

The election made by O and V fixes V's expenditure on the provision of the fixture at £5,000 for all purposes of the rules for plant and machinery allowances. In particular, it means that on a subsequent transaction involving the fixture, any election under either section 198 or 199 may not apportion an amount more than £5,000 to the fixture. This therefore includes the transaction between V and R.

Even though an election had already been made in respect of the sale by V to R, section 200(4) provides that this election is treated as fixing £5,000 as the consideration in respect of the fixture.

As a result, V must bring a disposal value of £5,000 into account and R may claim allowances in respect of expenditure of only £5,000 and not £10,000. Section 203(4) provides for adjustments to be made (for example to any assessments) as necessary.

Section 201: Elections under sections 198 and 199: procedure

723. This section is based on part of sections 51(2) and 59C of CAA 1990. It contains the procedural rules that apply to elections under sections 198 and 199.

Section 202: Interpretation

724. This section is based on section 51(2), (5) and (5A) and part of section 147(2D) of CAA 1990. It makes provision as to when a person is entitled to an allowance in respect of expenditure on the provision of a fixture. It also defines when "a person makes a claim under this Chapter".

725. As in section 8, this has been rewritten so as to refer to allocating expenditure to a pool. CAA 1990 refers to taking expenditure "into account" for the purposes of section 24 of CAA 1990.

726. *Subsection (1)* means "entitled to an allowance in respect of expenditure on the provision of a fixture" includes having a pool to which that expenditure has been allocated.

727. This ensures that the term picks up cases in which:

- a balancing charge arises in a particular pool; and
- the amount of the balancing charge is reduced because of the expenditure having been allocated to the pool.

728. *Subsection (2)* restricts this rule. It ensures that the term does not apply to a particular pool if, in a previous chargeable period, the taxpayer has been required to bring a disposal value into account in the pool in respect of the fixture.

729. Only disposal values brought into account by virtue of section 61(1) are affected by this. So, for example, a taxpayer is "entitled to an allowance" even if an additional VAT rebate has been made in respect of the fixture.

730. Furthermore, if a taxpayer starts to use a fixture partly for purposes other than that of the qualifying activity, a disposal value will be brought into account in respect of the pool to which the expenditure on the provision of the fixture was originally allocated. Subsection (2) means that the taxpayer will not be "entitled to an allowance in respect of the fixture" as far as that pool is concerned. However, the re-allocation of expenditure to a single asset pool under section 206(3) will mean that the taxpayer will be "entitled to an allowance in respect of the fixture" as far as the single asset pool is concerned. This is until there is a disposal event in respect of the single asset pool. The same applies if the taxpayer is in receipt of a partial depreciation subsidy.

731. *Subsection (3)* defines what is meant in the Chapter by "making a claim" in respect of expenditure.

Section 203: Amendment of returns and adjustment of assessments

732. This section is based on sections 51(6) and (6A) and 53(1H) and part of sections 51(2) and 53(1G) of CAA 1990. It puts an obligation on taxpayers to notify the Inland Revenue if a return has become incorrect for one of four specified reasons. It also provides that any necessary adjustments may be made to give effect to the various provisions of the Chapter.

733. *Subsection (2)* lists the four reasons that could give rise to an obligation on the taxpayer to notify the Inland Revenue of any return that has become incorrect.

734. *Subsection (3)* requires the notice to be given within three months of the taxpayer first becoming aware that the return had become incorrect because of such a reason. To

deal with cases in which the taxpayer does not meet this obligation, there are penalty provisions within section 98 of TMA 1970.

735. *Subsection (4)* provides that any necessary adjustments may be made to give effect to the various provisions of the Chapter.

Section 204: Appeals etc.

736. This section is based on sections 51(7) and 59C(8) of CAA 1990. It provides for special rules in appeals cases involving fixtures.

737. *Subsections (1)* to *(3)* deal with cases in which:

- there is a question as to whether any plant or machinery is a fixture; and
- that question is material to the tax liability of two or more persons.

738. *Subsections (4)* to *(6)* consider cases in which there is a question relating to an election under section 198 or 199 which is to be determined by the Special or General Commissioners.

739. These special rules are required as hearings by Commissioners are usually in private and these situations affect the tax liabilities of different taxpayers. It is therefore necessary to modify the normal procedures to allow all parties to appear before, or make written representations to, the Commissioners.

Chapter 15: Asset provided or used only partly for qualifying activity

Overview

740. This Chapter restricts writing-down allowances, balancing allowances and balancing charges for plant and machinery which is provided or used only partly for the purposes of the qualifying activity.

741. Section 205 deals with the reduction of first-year allowances if it appears that the plant or machinery is provided only partly for the qualifying activity.

742. Section 206 provides that qualifying expenditure on plant or machinery provided or used partly for the purposes of the qualifying activity and partly not is allocated to a single asset pool. It also gives rules for that pool.

743. Section 207 reduces writing-down allowances, balancing allowances and balancing charges for plant or machinery used partly for the purposes of the qualifying activity and partly not.

744. Section 208 is an anti-avoidance provision. It provides a disposal event if:

- there is a significant reduction in the use for the purposes of the qualifying activity; and
- the market value of the asset exceeds the available qualifying expenditure in the single asset pool by more than £1 million.

Background

745. The general conditions as to availability of plant and machinery allowances are in section 11. Subsection (4)(a) says that expenditure on the provision of plant or machinery has to be wholly or partly for the purposes of the qualifying activity. This Chapter explains how allowances are computed if use is only “partly”.

746. The idea is that allowances should be restricted in a “ just and reasonable” way having particular regard to the extent to which the plant or machinery is used for purposes other than those of the qualifying activity. In practice this means that allowances are

reduced proportionately for non-qualifying use (for example, private use in the case of a sole trader).

747. It would be impossible to achieve the correct adjustment if the expenditure was pooled with expenditure on other plant or machinery. So this Chapter requires a single asset pool. For rules about pooling in general see Chapter 5. Section 54(2) contains the rule that a single asset pool cannot contain expenditure relating to more than one asset.

Section 205: Reduction of first-year allowances

748. This section is based on section 79(1) of CAA 1990. It restricts first-year allowances.

749. *Subsection (1)* restricts a first-year allowance if it appears that the plant or machinery will be used for purposes other than those of the qualifying activity. The reduction of allowances must be just and reasonable having regard to the relevant circumstances.

750. *Subsection (2)* expands the meaning of "relevant circumstances". These include looking forward to the extent to which the plant or machinery is likely to be used for purposes other than those of the qualifying activity. There may be other circumstances.

751. *Subsection (3)* is makes clear the reduction in first-year allowances does not increase the qualifying expenditure on which writing-down allowances can be claimed in later chargeable periods. See *Note 38* in Annex 2.

Section 206: Single asset pool etc.

752. This section is based on section 79(2), (3) and (4) of CAA 1990. It provides for single asset pools for all expenditure incurred partly for the purposes of the qualifying activity and partly for other purposes.

753. *Subsections (1)* and *(2)* set up the single asset pool.

754. *Subsection (3)* sets up a single asset pool when any expenditure already in a pool starts to be use partly for purposes other than those of the qualifying activity. The plant or machinery will previously have been used wholly for the purposes of the qualifying activity. This subsection picks up the consequences of the disposal event in section 61(1)(e). The value of the disposal event will be market value, derived from the Table in section 61.

755. *Subsection (4)* disapplies section 61(1)(e) for expenditure already in a single asset pool under this Chapter.

Section 207: Reduction of allowances and charges on expenditure in single asset pool

756. This section is based on section 79(2), (5) and (6) of CAA 1990. It provides rules for balancing allowances and charges which are equivalent to those for writing-down allowances.

757. *Subsection (3)* expands the meaning of "relevant circumstances". These include looking forward to the extent to which the plant or machinery is likely to be used for purposes other than those of the qualifying activity. There may be other circumstances, including for example use in previous years.

758. *Subsection (4)* is new and is intended to clarify the position in future years of qualifying expenditure which was subject to a restriction of writing-down allowances under this section. See *Note 38* in Annex 2.

Section 208: Effect of significant reduction in use for purposes of qualifying activity

759. This section is based on section 79A of CAA 1990 which was introduced by section 79(2) of FA 2000. It is an anti-avoidance rule. It provides for a special disposal event at market value if:

- there is a significant reduction in the use for the purposes of the qualifying activity; and
- the market value of the asset exceeds the available qualifying expenditure in the single asset pool by more than £1 million.

760. *Subsection (1)* sets out the conditions that have to apply and *subsection (2)* gives the effect. The disposal value in *subsection (2)* will be market value (from the Table in section 61).

761. *Subsection (2)* will mean that the single asset pool ends and a new one begins because of the general pooling rules for the final chargeable period in section 65.

Chapter 16: Partial depreciation subsidies

Overview

762. This Chapter deals with partial depreciation subsidies. These occur if some other person makes a payment to take account of some of the depreciation on an asset.

763. Section 209 defines "partial depreciation subsidy".

764. Section 210 reduces first-year allowances if it appears that there will be a partial depreciation subsidy.

765. Section 211 provides that qualifying expenditure subject to a partial depreciation subsidy is allocated to a single asset pool and gives rules for that pool.

766. Section 212 provides for the reduction of writing-down allowances, balancing allowances and balancing charges for expenditure in a single asset pool under this Chapter.

Background

767. If the payment covers all of the depreciation, section 37 will prevent the plant or machinery qualifying for allowances unless the payment is taken into account as income.

768. This Chapter is similar to Chapter 15 in that it provides for a just and reasonable reduction of allowances and charges and for single asset pools to enable the reductions to be taken into account.

769. It would be impossible to achieve the correct adjustment if expenditure on the asset were kept in a pool with other assets. So this Chapter provides for single asset pools. For rules about pooling in general see Chapter 5. Section 54(2) contains the rule that a single asset pool cannot contain expenditure relating to more than one asset.

770. Section 80(7) of CAA 1990 has not been rewritten as such because it defines a term, "relevant period", which is not necessary in this Act.

Section 209: Meaning of "partial depreciation subsidy"

771. This section is based on section 80(1), (2) and (3) of CAA 1990. The term "depreciation subsidy" is new and is used in this Act instead of the term "wear and tear subsidy" which is used by section 80 of CAA 1990. See *Note 13* in Annex 2.

Section 210: Reduction of first-year allowances

772. This section is based on section 80(2) of CAA 1990. It provides for a just and reasonable reduction to any first-year allowance if it is appears that there will be a partial depreciation subsidy payable during the period of use.

773. *Subsection (2)* is new and is intended to clarify the position in future years of qualifying expenditure if a first-year allowance has been claimed which was subject to a restriction under this Chapter. See *Note 38* in Annex 2.

Section 211: Single asset pool etc.

774. This section is based on section 80(3), (4), (5) and (7) of CAA 1990. It sets up a single asset pool for qualifying expenditure on plant or machinery when a partial depreciation subsidy is paid.

775. *Subsections (3)* and *(4)* apply if the expenditure has already been allocated to a pool, and not previously been subject to a partial depreciation subsidy. When the subsidy is paid, there is a special disposal event and a single asset pool is set up. This is a disposal event in addition to those listed in section 61(1). The disposal value will be market value, as derived from the Table in section 61.

776. *Subsection (5)* stops there being a disposal event if:

- there is a change in the subsidy; and
- the expenditure is already in a single asset pool under this Chapter.

Section 212: Reduction of allowances and charges on expenditure in single asset pool

777. This section is based on section 80(3), (5)(b) and (6) of CAA 1990. It deals with the reduction of writing-down allowances, balancing allowances and balancing charges if a partial depreciation subsidy is paid.

778. *Subsection (3)* is new and is intended to clarify the position in future years of qualifying expenditure if a first-year allowance has been claimed which was subject to a restriction under this Chapter. See *Note 38* in Annex 2.

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.

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.

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.

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
- *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)* disapplies 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 disapplies 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.

Chapter 18: Additional VAT liabilities and rebates

Overview

Section 234: Introduction

832. This section introduces terms used in the Chapter. It refers users to the definitions of these terms in Chapter 2 of Part 12.

Section 235: Additional VAT liability treated as qualifying expenditure

833. This section is based on section 24(1A) of CAA 1990. It provides that an additional VAT liability may be treated as further qualifying expenditure.*Subsection (1)* provides the conditions for the section to apply. These are that:

- a person has incurred qualifying expenditure (this is known as "the original expenditure);
- an additional VAT liability is incurred in respect of the original expenditure; and
- the plant or machinery is (still) provided for the purposes of the qualifying activity when the additional VAT liability is incurred.

834. *Subsection (2)(a)* ensures that the additional VAT liability is then treated as further qualifying expenditure in respect of the plant or machinery. This is necessary to ensure that the cap on disposal values in section 62 correctly takes into account the additional VAT liability incurred.

835. *Subsection (2)(b)* allows this further qualifying expenditure to be taken into account in the chargeable period in which the additional VAT liability accrues.

Section 236: Additional VAT liability generates first-year allowance

836. This section is based on section 22(1A) and (1B) of CAA 1990. It ensures that, if the original expenditure also attracted first-year allowances, then the additional VAT liability may also qualify for first-year allowances.

837. *Subsection (2)(a)* provides that the additional VAT liability is the "same type" of first-year qualifying expenditure as the original expenditure. This wording is in line with the heading in the Table in section 52 which provides for different rates of first-year allowance depending on the circumstances of the first-year qualifying expenditure.

838. *Subsection (3)* ensures that:

- the Table of rates of first-year allowances in section 52 applies for the additional VAT liability as well as in respect of the original expenditure; and
- the taxpayer can choose to take a first-year allowance in respect of only part of the further qualifying expenditure.

839. *Subsection (4)* makes it clear that the availability of first-year allowances is subject to the rules in sections 237 (general exceptions) and 241 (anti-avoidance).

840. Some of the first-year allowance rules that could be invoked by this section are not generally relevant to this Act – for example, the rules applying to expenditure incurred between 1 November 1992 and 31 October 1993. If an additional VAT liability is incurred in respect of expenditure that qualified for a first-year allowance under those rules, the rate of first-year allowance on the additional VAT liability will be in accordance with those rules. For this transitional purpose, these rules are rewritten in paragraphs 46 to 51 of Schedule 3.

Section 237: Exceptions to section 237

841. This section is based on sections 22(3CA) and (6B) and 22B(1) of CAA 1990. It lists some of the circumstances in which a first-year allowance is not available in respect of an additional VAT liability.

842. Other circumstances are provided for in section 241. These circumstances are kept separate because section 241 is part of the anti-avoidance legislation.

843. This Act clarifies the rules that restrict the availability of first-year allowances in respect of additional VAT liabilities. See *Change 28* in Annex 1.

Section 238: Additional VAT rebate generates disposal value

844. This section is based on section 24(7) of CAA 1990. It requires, in certain circumstances, the recipient of an additional VAT rebate to bring the rebate into account as a disposal value. In most cases, this would simply reduce the available qualifying expenditure in the pool to which the original expenditure was allocated.

845. *Subsection (1)(c)* ensures that this section applies only if the recipient of the additional VAT rebate owned the plant or machinery during the chargeable period in which the rebate was made.

846. *Subsections (2)* and *(3)* ensure that the disposal value is brought into account in the chargeable period in which the additional VAT rebate accrues.

847. If another disposal value is to be brought into account in respect of the same plant or machinery in that chargeable period then the amount of the additional VAT rebate is added to this disposal value. The cap on disposal values in section 62 takes into account the combined amounts.

848. If there is no other disposal value to be brought into account in respect of the same plant or machinery in that chargeable period, then the disposal value to be brought into account is the amount of the additional VAT rebate. In these circumstances, the cap on the disposal value is given by section 239.

Section 239: Limit on disposal value where additional VAT rebate

849. This section is based on section 26(2A) and part of section 26(2), (3) and (4) of CAA 1990. It modifies the operation of the cap on disposal value in section 62 if there is, or has been, an additional VAT rebate in respect of the plant or machinery.

850. *Subsections (1)* and *(2)* apply if:

- there is an event giving rise to the disposal value which is not the making of an additional VAT rebate; and
- in respect of the plant or machinery there is an additional VAT rebate either in that chargeable period or in a previous chargeable period.

851. Subsection (2) ensures that the cap on the disposal value is reduced to take into account any previous additional VAT rebates. This ensures that any balancing charge may not exceed the total allowances previously given in respect of the plant or machinery.

852. *Subsections (3)* and *(4)* apply if the only event giving rise to a disposal value is the making of an additional VAT rebate.

853. Subsection (4) provides that the cap on the disposal value is reduced to take into account any previous disposal values brought into account in respect of the plant or machinery as a result of any earlier event.

854. These subsections contain a change. Section 26(2A) of CAA 1990 deals with the cap on disposal value when the event giving rise to the disposal value is the making of an additional VAT rebate. The words at the end of that subsection specifically state that previous additional VAT rebates should not be taken into account when operating the cap. The consequence of this is that in some situations a taxpayer can be required to bring in a disposal value in excess of the total qualifying expenditure incurred on the plant or machinery. This anomaly has been removed. See *Change 29* in Annex 1.

855. *Subsections (5)* and *(6)* modify the special rule in section 62(3). They apply when the person bringing into account a disposal value had acquired the plant or machinery from a connected person. For each connected person in a chain of transactions, it is necessary to calculate the total qualifying expenditure incurred on the plant or machinery net of any additional VAT rebates made. The cap on the disposal value is then the highest net qualifying expenditure of all the persons in the chain.

Section 240: Additional VAT liability

856. This section is based on section 37(4A) of CAA 1990. It applies if an additional VAT liability is incurred in respect of plant or machinery on which a short-life asset election has been made under section 85.

857. If a balancing allowance has been made following a disposal event in respect of a short-life asset pool, this section provides that a subsequent additional VAT liability may give rise to a further balancing allowance.

858. Normally, it is not possible for an additional VAT liability to be qualifying expenditure if it is incurred after the disposal of the plant or machinery. However, this section provides an exception if:

- the plant or machinery was subject to an election under section 85;
- a balancing allowance has arisen in the short-life asset pool;
- an additional VAT liability is incurred after the end of the chargeable period in which the balancing allowance was incurred; and
- the additional VAT liability was not taken into account when calculating the balancing allowance.

Example

S is a partially-exempt trader for VAT purposes. On 24 March 2002, S acquires a computer which is subject to the capital items legislation. For capital allowances, S elects for the expenditure on the computer to be allocated to a short-life asset pool.

Suppose S prepares accounts to 30 June each year, but S's VAT year ends on 31 March. Suppose S prepares quarterly VAT returns. On 1 May 2006, the computer is destroyed by fire. S is not insured for this loss. Suppose also that initial use of the computer was 90% for taxable supplies but this fell to 50% from 1 January 2006.

Under the provisions of section 61, S brings in a nil disposal value into account in the short-life asset pool. This will give rise to a balancing allowance in the chargeable period ending 30 June 2006. Under the capital items legislation, S must account for an additional VAT liability to reflect the reduction in use for taxable supplies in the period before the computer's destruction.

This must be accounted for in respect of the VAT year ending 31 March 2007 and will be shown on the VAT return in respect of the quarter ending 30 September 2007.

For the purposes of this section:

S was entitled to a balancing allowance for the final chargeable period for the short-life asset pool (which ends on 30 June 2006),

S incurred after the end of that period an additional VAT liability (on 31 March 2007); and

S did not bring the additional VAT liability into account in determining the amount of the balancing allowance.

As a result, this section entitles S to a further balancing allowance in respect of the additional VAT liability. Provided that the VAT return is made on time (and that S's trade has not been discontinued before this time) the further balancing allowance will be made in the chargeable period ending 30 June 2007.

Section 241: No first-year allowance in respect of additional VAT liability

859. This is the first of six sections that deal with the VAT aspects of the anti-avoidance provisions in Chapter 17.

860. Section 241 is based on parts of sections 75(1), (2) and (3), 76(1) and 76A(1) of CAA 1990. It ensures that the prohibition on first-year allowances imposed by sections 217 and 223 extends to any additional VAT liability incurred by the buyer in respect of the expenditure under the relevant transaction.

Section 242: Restriction on B's qualifying expenditure: general

861. This section is based on section 76(2), (2A) and (2B) and parts of sections 75(1), (2) and (3) and 76(4) of CAA 1990. It extends and replaces the rules in section 218 to deal with cases that would fall within that section if the expenditure also involves a VAT element. It ensures that the VAT is taken into account when restricting the allowances.

862. *Subsection (1)* applies the provisions of this section in place of those in section 218 when VAT is involved.

863. *Subsection (2)* sets the limit to the available qualifying expenditure by reference to the amounts D and E.

864. *Subsection (3)* defines "E" to include the additional VAT. This is subject to the rule for the case defined in subsection (6).

865. *Subsection (4)* defines "D" if the seller is required to bring a disposal value into account: D is that disposal value.

866. *Subsection (5)* defines "D" if the seller is not required to bring a disposal value into account. That may be because the seller is not within the UK tax net. In these circumstances D is the smallest of the three amounts specified. For those amounts other than the market value, the amount is adjusted to take account of the related VAT element.

867. *Subsection (6)* defines "E" if D is determined under subsection (5), as market value inclusive of VAT. E includes that VAT.

Section 243: Restriction on B's qualifying expenditure: sale and finance leaseback

868. This section is based on parts of sections 75, 76 and 76A of CAA 1990. It extends the rules in section 224 to deal with cases that would fall within that section if the expenditure also involves a VAT element. It ensures that the VAT expenditure is taken into account in restricting the allowances.

869. *Subsection (1)* applies the provisions of this section in place of those in section 224 when VAT is involved.

870. *Subsection (2)* sets the limit to the available qualifying expenditure by reference to the amounts D and E.

871. *Subsection (3)* defines "E" to include the additional VAT. This is subject to the rule for the case in subsection (7).

872. *Subsection (4)* defines "D" if the seller is required to bring a disposal value into account. In that case D is the amount given by applying the rules in section 222.

873. *Subsection (5)* defines "D" if the seller is not required to bring a disposal value into account. That may be because the seller is not within the UK tax net. In these circumstances D is the smallest of the three amounts specified.

874. *Subsection (6)* imports the meaning of "notional written-down value" (mentioned in subsection (5)) given by section 222(3).

875. *Subsection (7)* defines "E" if D is determined under subsection (5) as market value which is inclusive of VAT: E includes that VAT.

Section 244: B's qualifying expenditure if lessor not bearing non-compliance risk

876. This section is based on parts of section 76A(6), (7) and (8) of CAA 1990. It applies when section 225 applies to the arrangements because more than half the risk to the lessor is removed. It ensures that any additional VAT liability in respect of the expenditure subject to the section 225 restriction cannot, itself, be qualifying expenditure for capital allowances purposes.

Section 245: Effect of election under section 227 on additional VAT liability

877. This section is based on parts of section 76B(3)(a) and (b) of CAA 1990. It ensures that if the special treatment under section 227 applies, the VAT incurred by the lessee is subject to the same restriction as the capital expenditure to which it is related.

878. *Subsection (2)* states the effect of the section if it applies: the VAT element does not entitle the lessee to any capital allowances. This follows the similar prohibition in respect of the capital expenditure itself in section 228(5).

Section 246: Miscellaneous

879. *Subsection (1)* is based on section 75(5) of CAA 1990. It ensures that effect can be given to the sections in this Chapter, relating to the anti-avoidance provisions.

880. *Subsection (2)* is based on section 76A(11) of CAA 1990. It applies the "connected persons" definition in section 232 to the provisions that restrict qualifying expenditure in sections 242 and 243.

Chapter 19: Giving effect to allowances and charges

Overview

881. This Chapter provides how plant and machinery allowances and charges are given effect for income tax and corporation tax. There are specific rules for separate qualifying activities. There are additional rules for life assurance businesses.

882. The general rule in section 2 is applied in detail by:

- section 247 for trades;
- section 248 for ordinary Schedule A businesses;
- section 249 for furnished holiday lettings businesses;
- section 250 for overseas property businesses;
- section 251 for professions and vocations; and
- section 252 for mines, transport undertakings and other "section 55 concerns" (which give effect to allowances as expenses and charges as receipts of the trade or business or concern).

883. In addition:

- section 253 provides for investment companies to give effect so far as possible to allowances as a deduction from income of the business and charges as income of the business;
- sections 254 to 257 give effect to plant and machinery allowances and charges for management assets of a company carrying on life assurance business;
- sections 258 to 261 give effect to allowances and charges for special leasing of plant or machinery as a deduction from income from special leasing or a charge under Case VI of Schedule D respectively; and
- sections 262 gives effect to allowances and charges for employees and office-holders as deductions from emoluments or emoluments respectively.

Sections 247 to 252: Trades, property businesses etc.

884. These sections make very similar provision for giving effect to plant and machinery allowances for trades, property businesses, professions, vocations and section 55 concerns. These are all activities which Part II of CAA 1990 treats as trades for plant and machinery allowances – apart from section 55 concerns – which this Act treats as a qualifying activity. See *Change 1* in Annex 1. The sections are based mainly on section 73(1) of CAA 1990 which provides that allowances and charges are to be given effect in taxing a trade and the bits of Part VIII of CAA 1990 which explain what that means.

Section 253: Investment companies

885. This section is based on section 28 of CAA 1990. It provides for plant and machinery allowances and charges for the management of an investment company to be treated as expenses or income of the business. These are subject then to the provisions in section 75 of ICTA.

886. *Subsections (2)* and *(6)* refer to section 75(4) of ICTA. That provides (after the amendment made by paragraph 15 of Schedule 2 to the Act):

"(4) For the purposes of this section there shall be added to a company's expenses of management in any accounting period the amount of any allowances falling to be made to the company for that period by virtue of section 15(1)(g) of the Capital Allowances Act (plant and machinery allowances) so far as effect cannot be given to them under section 253(2) of that Act.

887. *Subsection (7)* points readers to provisions in ICTA which deal with a change in ownership of an investment company by providing for an apportionment of allowances between accounting periods if necessary.

Sections 254 to 257: Life assurance business

888. These four sections give effect to allowances for management assets of companies carrying on life assurance business. They are based mainly on section 434D of ICTA. "Management assets" are defined by section 544.

889. The background to the sections is, in summary, that the taxation of life assurance business is complex. It is a trade the profits of which could, and in certain cases must, be charged to tax under Case I of Schedule D. But a company carrying on life assurance business can also be taxed on the investment income of the company, plus capital gains on the investments, with relief given for the company's management expenses. This latter method is known as the "income less expenses" (I-E) basis of assessment.

890. If the I-E basis is chosen, a separate computation must be prepared for each category of life assurance business. The I-E basis itself applies to the income and gains of a company that are referable to its basic life assurance and general annuity business (BLAGAB). Where a company also carries on other categories of life assurance business, it is taxed on the profits of those categories, calculated in the same way as the profits of a trade are calculated, but charged under Case VI of Schedule D. This requirement for separate computations means that allowances have to be identified with each category of business. Section 255 does this. It provides for allowances and charges to be apportioned between categories of business:

- s*ubsection (1)* sets out the basic apportionment formula to be applied, subject to the special rule for overseas life assurance business in subsection (3);
- *subsection (2)* modifies the application of the formula to an overseas life insurance company; and
- *subsection (3)* provides that allowances on assets provided outside the United Kingdom for use in the management of an overseas life assurance business must be allocated to that business.

891. *Section 256* then gives effect to allowances and charges:

- for BLAGAB, subsections (2) and (3) treat allowances as management expenses and charges as income taxable under Case VI of Schedule D;
- for pension, ISA, life reinsurance and overseas life assurance business, subsections (3) and (4) treat allowances and charges as expenses or receipts of that business.

892. *Section 257* deals with various supplementary matters:

- *subsection (1)* ensures that allowances on "management assets" are only given effect in accordance with the special rules in the preceding sections;
- *subsection (2)* preserves the availability of allowances in "notional" computations under Case I of Schedule D, which may have to be prepared even if I-E is chosen as the basis on which tax is charged; and
- *subsection (3)* ensures that the various expressions used in the preceding sections continue to have the same meaning as in the main body of legislation dealing with the taxation of life assurance companies in Chapter I of Part XII of ICTA.

Sections 258 to 261: Special leasing of plant or machinery

893. These four sections give effect to plant and machinery allowances for special leasing. They are based mainly on sections 73, 141 and 145 of CAA 1990. The treatment of special leasing is different partly because there is, by definition, no trade or business (see section 19) and partly because of additional provisions in CAA 1990 for these allowances and charges.

894. *Section 258* for income tax deducts allowances from income from special leasing and taxes charges under Case VI of Schedule D. But this is subject to the restriction in subsection (3). That limits allowances to income from the particular special leasing if the lessee(s) did not use the plant or machinery for a qualifying activity for the whole tax year. Subsection (5) provides for excess allowances to be carried forward and set against future income from special leasing or (if subsection (3) applied) the particular special leasing. But, unlike CAA 1990, the section does not go on to say that tax "shall be discharged or repaid accordingly" as that is unnecessary. See *Note 40* in Annex 2. *Subsection (6)* is based on section 83(1) of CAA 1990. It treats a balancing charge on a special leasing as income so allowances can be set against it. See again *Note 40* in Annex 2.

895. *Sections 259* and*260* make similar provision for corporation tax. The main difference is that the rules for excess allowances are somewhat more complex and so given separately in section 260. The main difference from income tax is that a company has the option to deduct excess allowances from any profits in the same accounting period or carry back them to a previous accounting period (subject to the exception in *subsection (7)*).

896. *Subsection (8)* gives "profits" the meaning in section 6 of ICTA direct – like section 2(4).

897. *Section 261* is based on section 434E(6) of ICTA. It provides that a company carrying on any life assurance business cannot carry back excess allowances from special leasing or set them against other profits of the period or use them for group relief.

Section 262: Employments and offices

898. This section is based on section 27(1) and 140(4) of CAA 1990. It gives effect to allowances and charges in terms of deductions from emoluments and emoluments. This is in place of the terms "receipt" and "expense" in section 140 of CAA 1990. Those terms do not fit employees and office-holders. See *Note 41* in Annex 2.

Chapter 20: Supplementary provisions

Overview

899. This Chapter deals with partnerships and successions in the first six sections and miscellaneous plant and machinery provisions (rules for business entertaining, determination of questions about market value of property and shares in plant or machinery) in the final 3.

900. The partnerships and successions provisions in sections 263 to 268 are based on sections 65, 77 and 78 of CAA 1990.

901. The partnerships and successions provisions in sections 263 to 268 are related to provisions in Chapter 4 of Part 12, and section 343(2) of ICTA. They are also an exception to the general rule in section 15 that qualifying activities must be chargeable to tax.

902. Sections 558 and 559 provide similar rules to sections 263 and 265 for the rest of this Act except Part 6 (research and development).

903. For company reconstructions without a change in ownership section 343(2) of ICTA can apply.

904. Section 560 provides rules on the transfer of an insurance company business which affect all types of capital allowance including plant and machinery.

905. Section 561 deals with transfers of a UK trade between member states. It also applies to plant and machinery and takes priority over all other succession provisions.

Section 263: Qualifying activities carried on in partnership

906. This section is based on section 78(3) and (4) of CAA 1990. It maintains the entitlement to plant and machinery allowances (and liability to balancing charges) of the new partners after a partnership change.

Section 264: Partnership using property of a partner

907. This section is based on section 65(1) and (3) of CAA 1990.

908. Subsections (1) and (2) are based on section 65(1) of CAA 1990 and provide for plant and machinery allowances to be available to a partnership for property owned by one partner.

909. *Subsection (3)* is based on section 65(3) of CAA 1990 and provides an exception for assets leased to the partnership.

910. Section 61(2) stops transfers between partners being disposal events for plant and machinery and is based on section 65(2).

Section 265: Successions: general

911. This section is based on section 78(1) of CAA 1990. It deals with successions to trades which are deemed to be discontinued by either section 113(1) or 337(1) of ICTA.

912. It provides a general rule that if plant or machinery is transferred without sale on the succession to a trade which is deemed to discontinue under section 113(1) or 337(1) of ICTA, then the transfer will be at market value.

913. This rule is of little practical significance to the predecessor because, since 1994, section 113(1) of ICTA will deem there to be a discontinuance only if all the persons carrying on a trade change, so there will normally be an arm’s length sale. If there is not a sale then there will be a permanent loss to the old partnership anyway and a disposal event because of section 61(1)(b). There will also be a disposal event because of section 61(1)(f) just because the trade is deemed to be permanently discontinued. Section 61(3) will substitute market value.

914. Similarly the company discontinuance rule in section 337(1) of ICTA will trigger a disposal event within section 61(1)(f).

915. The rule is useful to the successor however because it clarifies that the property is acquired at market value.

916. *Subsection (1)* states when the section applies and *subsection (2)* deals with the deemed sale at market value. It also clarifies that the successor is deemed to acquire the property at market value as the other leg of the deemed sale.

917. *Subsection (3)* defines “relevant property”. Subsection (3)(a) requires that the property has to have been previously owned by the predecessor immediately before the succession. See *Change 30* in Annex 1.

918. *Subsection (4)* denies the successor any right to claim first-year allowances.

919. If the succession is between connected persons then an election to substitute a figure that will lead to no balancing allowance or charge may be available. See section 266 and paragraph 920 below.

Section 266: Election where predecessor and successor are connected persons

920. This section is based on section 77(3), (4), (5), (6) and (8) of CAA 1990. It provides for an election to be made if a trade is transferred between connected persons. The election has to be made by both of the parties to the transfer.

921. *Subsection (1)(b)* refers to "within the charge to tax" without the additional words "in the United Kingdom" used in section 77(3)(b) of CAA 1990. The words are not necessary. Omitting them brings this section into line with the wording used elsewhere in CAA 1990 and ICTA. See *Note 42* in Annex 2.

922. *Subsection (2)* provides for a predecessor and successor to "jointly elect". This is a change of wording from section 77 of CAA 1990. See *Note 43* in Annex 2.

Section 267: Effect of election

923. This section is based on section 77(4) and (7) of CAA 1990. It gives the effect of the election. The property is deemed to be transferred at a price which gives rise to neither a balancing charge nor a balancing allowance.

924. For the chargeable period in which a qualifying activity is discontinued (the "final chargeable period"), there can be no writing-down allowance (see section 55(4)) so this value will be the amount left in the pool at the end of the previous chargeable period. The predecessor will not get allowances for the period of transfer.

925. *Subsection (2)(a)* provides for a sale to be treated as occurring when the succession takes place. This is not explicit in section 77(4) of CAA 1990. See *Change 31* in Annex 1

Section 268: Successions by beneficiaries

926. This section is based on section 78(2) and (2A) of CAA 1990. It applies to a beneficiary of a deceased person who succeeds to a qualifying activity under a will or intestacy and acquires plant or machinery as part of the succession. It permits the beneficiary to make an election to treat the transfer as being at the lower of either market value or the amount left in the pool. It also treats the plant or machinery as if it was sold to the beneficiary when the succession takes place.

Section 269: Use of plant or machinery for business entertainment

927. This section is based on section 577 of ICTA. It prevents entitlement to plant and machinery allowances if an asset is used for business entertainment.

928. The section makes it explicit that the restriction applies to qualifying activities. Section 577 of ICTA applies to trades, and in CAA 1990 all types of qualifying activities are deemed to be trades. This is a consequence of the introduction of the term qualifying activity to replace deemed trades.

Section 270: Shares in plant or machinery

929. This section is based on section 83(4) of CAA 1990. It provides for plant and machinery allowances for shares in plant or machinery.