

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Plant and machinery allowances

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.

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(c.2) which received Royal Assent on 22nd March 2001*

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.

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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.