

# CAPITAL ALLOWANCES ACT 2001

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### *Glossary*

#### **Part 2: Plant and machinery allowances**

#### *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.

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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:

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- 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.

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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

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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.