*These notes refer to the Finance Act 2012 (c.14) which received Royal Assent on 17 July 2012*

# FINANCE ACT 2012

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## EXPLANATORY NOTES

### INTRODUCTION

***Section 42Schedule 9: Capital Allowances for Plant and Machinery: Anti-Avoidance***

### Summary

1. Section 42 and Schedule 9 amends the legislation that counters abuse of the rules for plant and machinery allowances, to make it more effective at preventing Exchequer loss. The changes will apply to expenditure incurred on or after 1 April 2012 (for businesses within the charge to corporation tax) and on or after 6 April 2012 (for businesses within the charge to income tax).

2. The legislation is also amended to confirm the meaning of the word 'assigns' for the purposes of the Capital Allowances Act (CAA)2001.

### Details of the Schedule

3. Paragraph (1) replaces section 215 of the CAA 2001: *Transactions to obtain allowances*, with new section 215 of CAA: *Transactions to obtain tax advantages*.

4. Subsection (1) of new section 215 provides that plant and machinery allowances will be restricted if a relevant transaction between B and S has an avoidance purpose, is part of a scheme or arrangement that has an avoidance purpose or occurs as a result of a scheme or arrangement with an avoidance purpose.

5. New subsection (2) provides that a relevant transaction can be treated as part of, or occurring as a result of, a scheme or arrangement regardless of when the scheme or arrangement is entered into or whether it is legally enforceable.

6. New subsection (3) defines an 'avoidance purpose': if the main purpose, or one of the main purposes, of a party in entering into a transaction, scheme or arrangement is to enable any person to obtain a tax advantage that would not otherwise have been obtained then that transaction, scheme or arrangement has an avoidance purpose.

7. New subsection (4) provides that a 'tax advantage that would not otherwise have been obtained' in subsection (3) includes an allowance that is in any way more favourable to any person – for example an allowance at a higher rate, claimed sooner or on a greater amount of qualifying expenditure – than the one that would otherwise have been obtained.

8. New subsections (5) and (6) provide that allowances may be restricted in different ways depending on the kind of tax advantage. Section 217 of CAA denies annual investment allowance or first-year allowance where the transaction has an avoidance purpose. The way in which writing down allowances may be restricted by new section 218ZA is determined by the nature of the tax advantage.

9. New subsection (7) describes two particular kinds of tax advantage: (a) the allowance is calculated using a higher rate than the one that would otherwise be used, or (b) the

allowance in respect of an amount of expenditure is available sooner than it would otherwise be. These particular kinds of tax advantage are specified to enable allowances to be restricted in an appropriate way, by new section 218ZA (5).

10. New subsection (8) provides that if a transaction, scheme or arrangement involves more than one tax advantage (for example, allowances at a higher rate on a greater amount of expenditure) then allowances may be restricted in more than one way.

11. Paragraph (2) amends section 57 (3) of CAA to ensure that expenditure excluded by new section 218ZA is not included in the amount of a person's available qualifying expenditure.

12. Paragraphs (3) and (4) amend sections 214 and 216 respectively to reflect the introduction of new section 218ZA. Allowances may be restricted under section 218 where there is a transaction between connected persons (within section 214) or where there is a sale and leaseback transaction (within section 216). If a connected person transaction or a sale and leaseback also has an avoidance purpose, or is part of a scheme or arrangement with an avoidance purpose, then allowances may be further restricted under new section 218ZA(3).

13. Paragraph (5) makes various amendments to section 218 so that section 218 will no longer restrict allowances where there is a transaction to obtain tax advantages within section 215, unless the transaction falls within section 215 *and* section 214 (connected persons transactions) or section 215 *and* section 216 (sale and leasebacks).

14. Paragraph (6) inserts new section 218ZA of CAA which determines how writing-down allowances are to be restricted where there is a transaction to which section 215 applies. New section 218ZA applies even if the transaction also falls within section 214 (because it is a connected person transaction) or within section 216 (sale and leasebacks). New section 218ZA operates by restricting the allowances that B can claim following the transaction (B is the person who has incurred, or is treated as having incurred capital expenditure on the provision of plant and machinery). Allowances can be restricted by reducing the amount of expenditure on which B can claim allowances, by reducing the rate at which allowances are given or by reversing any timing advantage sought (or any combination of restrictions).

15. New section 218ZA subsection (1) provides that where there is an avoidance purpose the amount of expenditure on which B can claim capital allowances is restricted. The restriction of allowances is made under this subsection *unless* the tax advantage is within section 215(7), that is, either that B's allowances are calculated at a higher rate or B is entitled to an allowance sooner than it would otherwise be.

16. New subsection (2) explains that, if new subsection (1) applies, B's qualifying expenditure is restricted by the amount that would in effect cancel out the tax advantage whether or not the tax advantage arises to B. However, the restriction can never be more than B's expenditure under the relevant transaction.

17. New subsections (3) and (4) provide that if B's writing-down allowances could be restricted both under subsection (1) (because there is an avoidance purpose) and also under section 218 or section 228, then B's allowances are restricted by the amount that is the larger of the two restrictions.

18. New subsection (5) provides that if the tax advantage is within section 215(7) – where B's allowances have been calculated at a higher rate or claimed sooner than they would otherwise have been - then the restriction is that B's writing-down allowances are calculated using the rate that would have been used or the entitlement is delayed to when it would have been available without the tax advantage.

19. New subsection (6) provides that a restriction calculated under subsection (5), by reference to the rate or timing of B's allowances, can be made in addition to a restriction under section 218 or section 228.

20. Paragraph (7) provides that section 230 of CAA, as amended by section 686a, is further amended.

21. Subparagraph (2) amends subsection (1) of section 230 so that the 'exception for manufacturers and suppliers' from the restrictions in sections 218 and 217 will not apply if there is a transaction with an avoidance purpose, or which is part of or occurs as a result of a scheme or arrangement with an avoidance purpose, within section 215.

22. Paragraph (8) inserts new section 268E of CAA which confirms the definition of the terms 'assigns' and 'assignments' which apply for Part 2 of CAA.

23. Paragraph (9) provides that the amendments made by this section will apply from 1 April 2012 (for corporation tax purposes) and 6 April 2012 (for income tax purposes).

## Background Note

24. Depreciation of fixed assets charged in the commercial accounts of a business is not allowed as a deduction in computing the taxable profits. Instead capital allowances may be given at prescribed rates on certain assets, including plant and machinery. The Annual Investment Allowance (AIA) provides an annual 100 per cent allowance for the first £25,000 (this is the maximum annual allowance from April 2012) of investment in plant and machinery to all businesses. There are also 100 per cent first-year allowances (FYA) available for expenditure on certain types of plant or machinery. Otherwise expenditure on plant and machinery attracts writing down allowance (WDA) at the main rate of 18 per cent per annum or the special rate of 8 per cent per annum (these are the rates that apply from April 2012).

25. Chapter 17 CAA contains anti-avoidance rules that restrict the plant and machinery allowances that may be claimed following certain relevant transactions. A relevant transaction is one in which: • S sells plant or machinery to B, or

- B enters into a hire-purchase or similar contract for plant or machinery with S, or
- S assigns the benefit of a hire purchase or similar contract for plant or machinery to B

26. Allowances may be restricted where the relevant transaction is • between connected persons (defined in section 214), or

- a transaction to obtain allowances (defined in section 215), or
- a sale and leaseback (defined in section 216).

27. The anti-avoidance rules are being amended to make them more effective.

28. The 'sole or main benefit' test currently in section 215 is being replaced by a new 'purpose' test that will apply where the main, or one of the main, purposes of a party in entering into a transaction (or a scheme or arrangement of which the relevant transaction is part) is to enable any person to obtain a tax advantage that would not otherwise have been obtained. The tax advantage may arise to a party to the transaction or any other person.

29. A 'tax advantage' is defined in section 577(4) of CAA. The term includes allowances that are 'greater' or more favourable because the amount of qualifying expenditure has been artificially increased, because the allowances have been a claimed at a rate that is too high or because they have been claimed sooner than they should have been.

30. Where a transaction, scheme or arrangement has an avoidance purpose then B's allowances are restricted to, in effect, cancel the tax advantage. To this end, the restriction may be to reduce the rate at which B's allowances are calculated (if the tax advantage B would otherwise obtain is allowances at a rate that is too high) or to reverse any timing advantage sought by B so that B is, in both cases, in the position that B would

have been in without the tax advantage. In other situations B’s qualifying expenditure is restricted to an amount that has the effect of negating the tax advantage. If appropriate more than one restriction may be made to B’s allowances.

31. It is possible that a transaction with an avoidance purpose is also a connected person transaction or a sale and leaseback, in which case the application of the existing rules in section 218 or section 228 must also be considered and the largest applicable restriction made.

32. The ‘purpose’ test and the consequences of entering into a transaction, scheme or arrangement with an avoidance purpose are consistent with the approach used in other purpose tests elsewhere in the Taxes Acts.