Capital allowances

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Capital allowances on fit out and refurbishments

Summary

When fitting out or refurbishing an existing property there is increased scope to claim tax relief and in the case of refurbishments, there may also be an opportunity to claim a full write off on certain aspects of the expenditure incurred, by identifying items which can be categorised as repairs and maintenance.

Fit out and refurbishment of existing property relates to alterations of an existing envelope. The structure, floor, ceilings and walls have all previously been installed and as such these works relate more to getting the property ready for business use.

However, in order to maximise the tax relief it is necessary to fully understand the construction principles behind the works undertaken.

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Works incidental to the installation or removal of plant

One of the main considerations either overlooked or not fully utilised is works that are incidental to the installation or the removal of plant. Take, for example, a case where a landlord has to install a new passenger lift in a building. For new construction the installation of the lift shaft would not qualify for capital allowances. However, in an existing building these subsequent works are incidental to the installation of the lift and as such would qualify. Similarly, a tenant may wish to install new air condition to their existing office. If it is deemed that the most efficient manner to undertake the works is to remove the existing ceiling, install the air conditioning and duct work and then replace with a new ceiling, all these works are incidental to the installation of the air conditioning.

Repairs & maintenance expenditure

Properties which are deemed to be capable of use, or indeed are currently in use, may attract a high level of expenditure categorised as repair and maintenance, if the works can be considered a 'like for like' replacement or the 'modern day equivalent' For example, timber frame single glazed windows can be replaced with double glazed, uPVC framed windows; which is deemed the 'modern day equivalent' Accordingly for tax purposes this can be treated as a fully deductible expense.

Initially the expenditure may be 'capitalised' in the accounts as it forms part of a larger refurbishment project. However, one may only be able to deduct it as an expense it is included in the profit and loss account, so early consideration is required about the intended treatment and depreciation policy. In order for the expenditure to qualify as a revenue deduction it needs to be either a 'like for like replacement' of the existing or the modern day equivalent.

However, any item of expenditure which may qualify for capital allowances; cannot be included as a revenue item if it has been substantially replaced.

Using the previous scenario where a ceiling has been removed to help facilitate the installation of air conditioning, if the main reason behind the installation of a new ceiling was because the existing ceiling was beyond economical repair then the expenditure could potentially be treated as repairs and maintenance.

However, if the air conditioning was also being replaced, since it qualifies for capital allowances, if it is 'substantially' replaced then it can not be treated as revenue and should be taken as qualifying capitalised expenditure (subject to capital allowances).

Enhanced capital allowances

With early involvement your capital allowances advisor can help improve the rate these capital allowances are realised. This can be the difference between claiming the tax relief as 100% WDA rather than 8% in the year of expenditure.

In one particular case a client was spending around £1m every year on lighting installations. By identifying a different light fitting model by the same manufacturer the expenditure qualified as enhanced capital allowances, enabling the client to benefit from circa £200,000 of tax relief immediately rather than over a number of years. In certain situations the enhanced capital allowances may be surrendered for a tax credit.

Earlier involvement can lead to greater levels of tax relief

Early capital allowances involvement on refurbishment or fit out projects allows the consultant to document the information in greater detail; in turn this will assist in ensuring that the allowances are maximised.

The following example review took place recently where we were involved from the start of the project.

By visiting the property prior to the works, we were able to document the works incidental to the removal of existing plant as well as the works incidental to the installation of new plant.

Total expenditure qualifying for:	Total qualifying project expenditure
Capital allowances total	£726,007
Revenue deductions:	£536,389
Non qualifying expenditure:	£319,461
Total expenditure	**£1,581,856**

This was one of the main reasons we were able to identify tax relief on around 80% of the total expenditure. Works incidental to the removal of old plant and the installation of new plant amounted to around 15% of the above capital allowances claim value. Since the works were incurred as part of an LLP, the recovery relates to a tax deduction of some £500,000 (assuming a 40% tax rate) realised over the next few years.

Conclusion

Capital allowances on existing properties can be more complex; however with detailed information, the review of the expenditure may yield tax relief on a significant percentage of the overall spend. Knowledge of the works incidental to the installation or removal of plant can also significantly improve the level of qualifying expenditure.

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