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## **Plant and Machinery Capital Allowances: Anti-Avoidance**

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Draft legislation and technical background  
Tax Information and Impact Note  
12 August 2011

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## Chapter 1 Draft legislation

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### **1 Capital allowances: restricting exception for manufacturers and suppliers**

- (1) In section 230 of CAA 2001 (exception for manufacturers and suppliers), in subsection (1), for “restrictions in sections 217 and 218 do” substitute “restriction in section 218 does”.
- (2) The amendment made by this section has effect in relation to expenditure of B’s that is incurred on or after 12 August 2011 (regardless of when the relevant transaction was entered into).

## Chapter 2 Technical background

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The Government is taking action today to counter a marketed avoidance scheme designed to accelerate capital allowances claims and obtain advantageous early tax relief. Draft legislation that amends the existing anti-avoidance legislation is published today as set out in Chapter 1, to be included in the 2012 Finance Bill.

### Current Law

Chapter 17 in Part 2 of Capital Allowances Act 2001(CAA) already contains anti-avoidance legislation that applies to transactions involving plant or machinery. Broadly, the existing legislation is intended to protect the Exchequer against transactions to inflate or accelerate capital allowances claims.

For the anti-avoidance legislation to apply there must have been a 'relevant transaction' involving plant and machinery (P&M). A relevant transaction is defined in terms of one between a person 'B' – the "buyer" and claimant of the capital allowances – and a person 'S' – the "seller". (Not all relevant transactions are sales.)

A relevant transaction is one where

- S sells P&M to B, or
- B enters into a contract with S providing that B may become the owner of the P&M at the end of the contract – in other words where B enters into a hire-purchase, or similar, contract with S, or
- S assigns the benefit of a contract under which S may become the owner of the P&M to B – in other words where S assigns the benefit of a hire purchase, or similar, contract to B.

The legislation operates by restricting allowances due by reference to B's expenditure under a relevant transaction. The 'expenditure under a relevant transaction' is the amount of capital expenditure B incurs either to buy the P&M, under the hire-purchase contract or for the assignment of the hire-purchase contract.

Capital allowances are, however, only restricted in the following circumstances:

- B and S are connected with each other (section 214 CAA). 'Connected' takes its usual meaning from section 575 CAA and can apply to companies, partners and individuals, or
- The relevant transaction between B and S is a 'transaction to obtain allowances' – section 215 CAA refers, or

- S sells the P&M to B but S (or a person connected with S) leases the P&M back and continues to use it in their qualifying activity. Section 216 CAA refers.

A 'transaction to obtain allowances' is defined in section 215 CAA as a relevant transaction where it appears that capital allowances are the sole or main benefit which might be expected to accrue to B or to S, or indeed to any other party, from the transaction. A series of transactions is specifically brought within the scope of the legislation (section 215 (b) (ii)); the relevant transaction must be one of the transactions in the series.

Where there is a relevant transaction within the scope of the legislation capital allowances may be restricted in one of two ways:

- (i) Firstly, section 217 CAA denies the claimant, B, annual investment allowance (AIA) or first-year allowance (FYA) in respect of expenditure under the relevant transaction.
- (ii) Secondly, section 218 CAA restricts the amount of qualifying expenditure on which B can claim capital allowances.

However, section 230 CAA contains an exception from section 217 CAA and section 218 CAA for 'manufacturers and suppliers'. This exception applies where S sells P&M to B, or there is a hire-purchase contract between S and B, and S's business is to manufacture or supply that type of P&M. For this exclusion to apply the P&M must have been sold to B in the normal course of S's business and must not have been used before the sale.

The effect of section 230 CAA is that B is not prevented from claiming AIA or FYA where P&M has been bought, or hire-purchased, from a manufacturer or supplier even when it is acquired from a connected person, under a transaction to obtain allowances or leased-back to the seller. Similarly section 230 ensures that the amount of B's qualifying expenditure will not be restricted by the anti-avoidance rules in these circumstances.

## **Abuse**

There is evidence that these anti-avoidance rules, as currently drafted, are not always as effective as they could be. Robust legislation to prevent avoidance at the outset is one of the core elements of HMRC's anti-avoidance strategy. To this end the Government proposed four changes to the drafting of these rules in a consultation document '*Changes to the capital allowances anti-avoidance rules for plant and machinery*' which was published on 31 May 2011. This stage of the consultation, which seeks views on the impact of the proposed changes, ends on 31 August 2011. The proposal is that the amendments will be included in the 2012 Finance Bill and would take effect for expenditure incurred on or after April 2012.

One of the changes proposed in the consultation document is the repeal of the exclusion, provided by section 230, from the anti-avoidance rules where plant or machinery is

acquired from a manufacturer or supplier in the normal course of business. This proposal was made in the light of evidence that transactions were being put in place to side-step the effects of the anti-avoidance rules by using this exception.

It has very recently come to the Government's attention that at least one avoidance scheme is being promoted that seeks to take advantage of the section 230 exception in a way that was not intended. The scheme would enable companies to artificially accelerate claims to first-year allowances and obtain advantageous early tax relief.

For **example**: Company X Ltd is to buy a significant item of purpose built plant or machinery (P&M) with a cost in the order of £2bn. The P&M qualifies for 100% first-year allowances. The P&M is acquired from the manufacturer and would, absent any tax avoidance motivated restructuring of the transaction, be paid for in instalments over the 4 year construction period. X Ltd would be able to claim first-year allowances on the expenditure as it is incurred over the 4 year period.

To accelerate the capital allowances available two steps are inserted into this transaction. Firstly, the rights and obligations under the contract to acquire the P&M are assigned to a subsidiary of X Ltd which is a procurement company, and secondly, a hire purchase agreement is put in place between X Ltd and the procurement company, structured so that an upfront balloon payment (of almost the entire £2bn) is made by X Ltd. X Ltd becomes entitled to claim 100% first-year allowances on the full £2bn when paid at the start of the contract rather than on the amounts actually paid to the manufacturer over the 4 year period.

X Ltd and the procurement company are connected parties so section 214 CAA together with section 217 should deny X Ltd 100% first year allowances in respect of the acquisition of the P&M from the procurement company. However, section 230 provides an exception from section 217 because the procurement company's business is the supply of plant and machinery of that class.

The scale of the tax potentially at risk from the schemes is such that the Government has decided to act now to counter the schemes despite the fact that the consultation on the proposed changes to the capital allowances anti-avoidance legislation is still ongoing.

### **The change**

The change announced is to legislate with effect from today 12 August 2011 to partially repeal section 230 CAA. We will include this legislation in the next Finance Bill.

For expenditure incurred on or after 12 August 2011, section 230 CAA will no longer provide an exclusion from section 217 CAA where B has acquired plant or machinery from S in the normal course of S's business to manufacture or supply such plant or machinery.

In other words, where B has acquired plant or machinery from S under a relevant transaction, B will not be entitled to claim AIA or FYA in respect of expenditure incurred under the relevant transaction where either:

- B and S are connected persons, or
- The transaction is a transaction to obtain allowances, or
- B leases the plant or machinery back to S and S continues to use the plant or machinery in a qualifying activity.

This is the case even where S has sold, or hire-purchased, the plant or machinery to B in the normal course of a manufacturing or supply business.

The change applies to expenditure incurred on or after 12 August 2011, regardless of when the sale or hire-purchase contract was entered into.

For the avoidance of doubt, section 230 will continue to provide an exception from section 218 CAA where the appropriate conditions are met (S sells or hire-purchases unused plant or machinery to B in the normal course of its business). The effect of this is that where B has, for example, bought unused plant or machinery from manufacturer S in the normal course of S's trade and B and S are connected, then B may not claim AIA or FYA but there will be no restriction of qualifying expenditure under section 218 CAA.

The Government still proposes to repeal section 230 in its entirety, subject to analysis of any consultation responses, with effect from April 2012. There is still time to make representations on this and the other proposals in the consultation document, until the consultation closes on 31 August 2011. Representations will be taken into account when finalising the legislative changes required to give effect to the proposed repeal announced today.

## **Contact details**

If you have any questions about this change please contact Sue Pennicott on 020 7147 2610 (email: [sue.pennicott@hmrc.gsi.gov.uk](mailto:sue.pennicott@hmrc.gsi.gov.uk)) or Malcolm Smith again on 020 7147 2610 (email: [malcolm.smith3@hmrc.gsi.gov.uk](mailto:malcolm.smith3@hmrc.gsi.gov.uk))



### **Change to the capital allowances anti-avoidance rules for plant and machinery**

#### **Who is likely to be affected?**

Businesses that incur capital expenditure on or after 12 August 2011 to buy or hire-purchase plant or machinery in one of these circumstances:

- (i) the buyer and seller of the plant or machinery are connected, or
- (ii) the transaction was put in place solely or mainly to get the benefit of capital allowances, or
- (iii) the plant or machinery was sold and then leased-back to the seller

#### **General description of the measure**

The capital allowances anti-avoidance rules deny first-year allowances or annual investment allowance for expenditure on plant or machinery if:

- (i) the buyer and seller of the plant or machinery are connected, or
- (ii) the transaction was put in place solely or mainly to get the benefit of capital allowances, or
- (iii) the plant or machinery was sold and then leased-back to the seller and the seller continues to use the plant or machinery for the purposes of a qualifying activity.

There is however currently an exception to this where the plant or machinery has been bought, or hire-purchased, from a manufacturer or supplier in the normal course of the seller's business.

The Government has announced today, 12 August 2011, that this exception is partially repealed for expenditure incurred on or after 12 August 2011. Legislation will be included in the next Finance Bill. This brings forward (part of) one of the changes proposed in the Consultation Document 'Changes to the capital allowances anti-avoidance rules for plant and machinery' published on 31 May 2011.

#### **Policy objective**

This measure will support the Government objective of fairness in the tax system by protecting the Exchequer from loss of tax as a result of avoidance schemes designed to take advantage of the exception from the anti-avoidance rules that applies where plant or machinery has been acquired from a manufacturer or supplier in the normal course of business.

## **Background to the measure**

The Government proposed changes to the capital allowances anti-avoidance rules that apply to transactions involving plant or machinery in a consultation document published on 31 May 2011. The proposal was that the changes would be effective from April 2012.

The Government has announced that one of the proposed changes announced in the consultation document will be effective - in part - from 12 August 2011. This is because the Government is aware that schemes are being promoted that seek to exploit the 'manufacturers and suppliers exception'.

## **Detailed proposal**

### **Operative date**

The legislative change will have effect in relation to expenditure incurred on or after 12 August 2011.

### **Current law**

The Annual Investment Allowance (AIA) enables all businesses to claim full tax relief on most plant or machinery expenditure up to an annual limit of £25,000. First-year allowances (FYA) are special allowances, available in respect of specific types of expenditure only, that enable a business to relieve the entire cost of plant or machinery against profits in the period in which the expenditure is incurred.

The capital allowances anti-avoidance legislation denies AIA and FYA where there is a sale or hire purchase of plant or machinery if either

- (i) the buyer and seller of the plant or machinery are connected, or
- (ii) the transaction was put in place solely or mainly to get the benefit of capital allowances, or
- (iii) the plant or machinery was sold and then leased-back to the seller and the seller continues to use the plant or machinery for the purposes of a qualifying activity.

However there is an 'exception for manufacturers and suppliers': where the plant or machinery has been bought or hire-purchased from a manufacturer or supplier of such plant or machinery in the normal course of business, then the buyer is not precluded from claiming FYA or AIA. The plant or machinery must never have been used before the sale or the making of the hire-purchase contract.

### **Proposed revisions**

The change to the law partially repeals the 'exception for manufacturers and suppliers'. Where expenditure is incurred on or after 12 August 2011 to buy or hire-purchase plant or machinery, AIA or FYA is denied, without exception in any of these circumstances:

- (i) the buyer and seller of the plant or machinery are connected, or

- (ii) the transaction was put in place solely or mainly to get the benefit of capital allowances, or
- (iii) the plant or machinery was sold and then leased-back to the seller and the seller continues to use the plant or machinery for the purposes of a qualifying activity.

## Summary of impacts

<b>Exchequer Impact</b>	At this stage it is expected that no yield for the Exchequer will be scored for this measure but the final costing will be subject to scrutiny by the Office for Budget Responsibility and will be set out at Budget 2012. However the change does protect substantial amounts of tax accruals for the Exchequer for some businesses' accounting periods covering the period up to April 2012 which could otherwise be at risk.
<b>Economic impact</b>	This measure is not expected to have a significant impact on the UK economy in overall terms and the change to the anti-avoidance rules will not disrupt or distort normal commercial activities.
<b>Impact on individuals and households</b>	This measure will have no direct impact on individuals or households as this measure only affects businesses.
<b>Equalities impacts</b>	The proposal is not likely to impact differently on groups with protected characteristics as the sole determinant of whether or not these provisions apply is whether the business is engaged in tax avoidance.
<b>Impact on business including civil society organisations</b>	The proposed changes will not reduce the amount of qualifying expenditure on which businesses can claim capital allowances; the impact is to prevent businesses artificially accelerating capital allowances claims and obtaining tax relief in advance of expenditure actually having been incurred. While there may be some minor one-off costs for businesses related to familiarisation with the new rules, we think that the impacts on businesses' ongoing administrative burdens will be negligible and the impact will fall mainly on firms which are actively engaged in tax avoidance.
<b>Operational impact (£m) (HMRC or other)</b>	Improving the capital allowances anti-avoidance rules will have a slight favourable impact on HMRC, reducing the resource time and costs of tackling tax avoidance.
<b>Other impacts</b>	Small firms (those with fewer than 20 employees) are included in this measure. This is because to exclude them would not achieve the policy objective.  As an anti-avoidance measure this should have a positive effect on

competition by levelling the playing field for all businesses.
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### **Monitoring and evaluation**

This policy will be evaluated through responses to the consultation on the draft legislation published on 12 August 2011 and through responses to the ongoing consultation on the other proposed changes to the capital allowances anti-avoidance rules. HMRC will also monitor businesses' tax affairs to ensure that the types of tax avoidance these changes are intended to prevent do not occur.

### **Further advice**

If you have any questions about the change announced today please contact Sue Pennicott on 020 7147 2610 (email: [sue.pennicott@hmrc.gsi.gov.uk](mailto:sue.pennicott@hmrc.gsi.gov.uk)) or Malcolm Smith again on 020 7147 2610 (email: [malcolm.smith3@hmrc.gsi.gov.uk](mailto:malcolm.smith3@hmrc.gsi.gov.uk)).

### **Declaration**

Justine Greening MP, Economic Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.