Capital allowances: feed-in tariffs and the renewable heat incentive

Government giveth with one hand and taketh away with the other

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ALA is planning a response to government on this consultation. The author would welcome Members' feedback on the subject of this article. Please email your comments to *carlton@landtax.co.uk* by 15th August 2011.

HMRC have issued a consultation on the rate of capital allowances (for Income Tax and Corporation Tax purposes) for expenditure on plant and machinery used to generate feed-in tariffs (FITs) and the Renewable Heat Incentive (RHI). The consultation, which runs to 31st August, has a stated objective: "to fix a rate of capital allowances for such expenditure that is both fair and certain, and ensure more consistent treatment between businesses". The new rules will apply from April 2012.

We are in again in the 'fair' world of doublespeak. Government has 'pump primed' the renewables sector with the introduction of the FITs regime from April 2010 and of the RHI. But government is now concerned to ensure that investors are not overly rewarded with public subsidy. So we are to have more tinkering with an existing system, i.e. more legislation, to give businesses 'certainty' about the (reduced) capital allowances they are to obtain.

Now this may sound reasonable, as we have a capital allowance regime with:

1. enhanced capital allowances of 100% of all expenditure on energy or water efficient technologies;
2. an Annual-investment Allowance (AIA) of 100% for expenditure up to a set limit (£25,000 from April 2012);
3. for expenditure in excess of the AIA, a writing down allowance (WDA) is given each year at a rate, from April 2012, of:
   - 3.1 18% for most expenditure on plant and machinery (main pool expenditure); and
   - 3.2 8% for special rate expenditure, which includes expenditure on integral features of a building and on long-life assets (useful economic life of more than 25 years).

This is a complicated system, but these are the current set of rules that accountants are used to considering.

The proposals in the consultation are that, from April 2012, all expenditure on plant and machinery that could qualify for FITs or RHI tariff payments should only qualify for the 8% special rate. This is because the legislation is complex to interpret and Government is concerned that such interpretation could lead to inconsistency of treatment between businesses.

Without regard to the practical effect of this proposal, it does sound reasonable, as practitioners do generally welcome certainty. Government is therefore to be congratulated on addressing this matter relatively early after it became an issue.

However, let us consider the practical implications for the smaller scale projects that could be carried out by many farmers in terms of a solar PV installation.

1. The sale of electricity from residential solar PV installations is tax-free, so it is therefore worthwhile considering whether the PV installation can be fragmented, to bring part within the domestic microgeneration exemption (s782A, ITTOIA 2005). The income from this element will necessarily be low (perhaps between £1,000 to £2,000 per annum plus savings to the domestic electricity bill) to fall within the exemption, but this is worthwhile considering. Clearly capital allowances and VAT cannot then go through the business, but the long term return should be much better if tax-free.
2. A business will still be able to claim the Annual-investment Allowance on the first £25,000 of expenditure in a tax year. Might we therefore see non-corporate businesses setting up a separate entity, for example a separate partnership or stand alone company, in order to take advantage of the AIA and spreading the expenditure between two tax years?
3. Although with a solar PV installation the solar panels probably have a useful economic life of more than 25 years, some of the equipment that is used will have a shorter life, such as the inverter used to convert the DC electricity produced by the PV panel to AC electricity to be sold to the Grid.

Similar considerations will apply for hydro and wind projects, but it should be noted that the FIT regime for these only applies for 20 years and so is shorter than the useful economic life of more than 25 years required for long-life assets.

As noted above, I do welcome the idea of providing certainty on the capital allowances available on this type of expenditure. However, this could be seen as a justification by government for now clawing back some of the

> "The idea of providing certainty on capital allowances is to be welcomed but the changes could be seen to justify the clawing back of incentives"

incentive that they have agreed to provide. The assessment in the consultation document is that this proposal is expected to increase tax receipts by approximately £185 million by 2016/17.

So as to keep the tax system as simple as possible, the author would suggest that the government might accept that an increase in the Annual-investment Allowance, say £10,000, be available to businesses that invest in FIT or RHI technologies where the AIA is also claimed on other types of capital expenditure. This would:

- provide some relief to take account of the expenditure on equipment that does not have a useful economic life of more than 25 years;
- reduce the incentive of creating a separate entity entirely for the purpose of increasing the overall AIA available; and
- keep the system relatively simple.

The detailed proposal is linked to one of the 31st May publications at *http://www.hmrc.gov.uk/budget-updates/march2011/index.htm*

Also, on 27th May, the Treasury issued a consultation document on the abolition of 36 tax reliefs that are "obsolete, unnecessary and distortive", including relief for mineral royalties which will be of particular interest for landowners.

Briefly, the 50% split of mineral royalty income between Income and Capital Gains treatment (s.157, ITTOIA 2005 & s.201 TCGA 1992 for individuals) is to be abolished from 6th April 2013 with all mineral royalties thereafter being liable to Income Tax (or Corporation Tax for companies).

This will increase the tax payable by individuals and trusts, as there will be no Capital Gains annual exemption available. Also the rate of tax payable on Income is greater than on Capital Gains.

The consultation is not on the proposed abolition of the relief, but only on whether "transitional arrangements for the removal of reliefs are fair and proportionate".

One could become very cynical about the Office of Tax Simplification's project for a clearer and more straightforward tax system. The changes all appear to have been revenue raising and although they may simplify the tax system, there must be a question mark over their 'fairness'.

Finally, you may like to note that the exemption from excise duty for "black beer" will be abolished from April 2013. This exemption was originally put in place (in 1901) due to the historic belief that black beer has medicinal and nutritional properties and apparently black beer was the original black in a rum and black (rather than blackcurrant, as today). However, black beer is generally of high alcoholic strength (around 8.5% abv) and so the Treasury have concluded that it can no longer be considered a 'health' product.

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Surrender and regrant of Agricultural Tenancies

CAAV Numbered Publication 205, price £75 (to non-members of CAAV)

The idea of surrendering one tenancy agreement and replacing it with another is nothing new and, in legal terms, a relatively straightforward operation. When you bolt onto it the implications for security of tenure that the agricultural context raises, it takes on a different complexion. Add to that the tax motivation that has more recently driven many such arrangements and you are in a particularly cloudy area.

This new publication from CAAV doesn't contain all the answers, but it does a remarkable job on collating and discussing the questions, so as to make all professions – lawyers, accountants and consultants as well as suveyors and valuers – aware of the difficulties and offer signposts to the problem areas.

The legal framework is presented relatively shortly, but adequately underlines the requirements for surrender and regrant, in particular the characterstics which give rise to an implication of law to that effect. Then came the uncertain effect of the original s.4(1)(f) Agricultural Tenancies Act 1995, modified by the 2006 RRO and added to with the new s.4(1)(g), which together provide that surrenders and regrants, implied or express, do not inherently lose security of tenure for the tenant when applied to tenancies under the 1986 Act.

The combined effect of these two and the increased rate of relief from inheritance tax for landlords of lettings dating from after 1st September 1995 has, as the booklet points out, led to a culture of engineering situations to take advantage of that benefit.

However, as the booklet equally quickly and very thoroughly makes clear, that is not all there is to it. There are issues of Stamp Duty Land Tax and Capital Gains Tax, for example, which may muddy the water. Helpfully, since an adviser of whatever hue will inevitably be advising either landlord or tenant, there are sections devoted separeately to each which view the issues from that party's peculiar perspective.

The landlord's adviser will want to be aware of the passages examining the potential for sham and the consequences of transactions having no commercial reason – the form is important but the substance even more so. Those points aside, the text concludes that the landlord's position is tolerably clear, although not wholly so.

The tenant's position, however, is clearly far less so and advisers will need to consider, inter alia, potential for SDLT consequences. Correspondence between CAAV HQ and HMRC on the point is quoted but not wholly conclusive.

The tenant's CGT issues, similarly, present more questions than answers concerning the effect of the surrender as a potential disposal for CGT purposes. The possibilities are well rehearsed in the text.

It is clear also that in appropriate cases the VAT impact of the surrender, a chargeable supply by the tenant, should not be overlooked, although it will require both the tenant to have opted to waive exemption and the landlord not to be registered for there to be a significant problem.

The booklet deals also, as one would expect from this stable, with the associated valuation questions. It posits finally a series of alternative approaches to concluding an arrangement which will satisfy both parties and steer them around the pitfalls.

This is a developing area of law and practice and, as always, the sort of focused thought presented in this publication will help practitioners of all persuasions to come to terms with the issues involved. As I said at first, it does not have all the answers, because not all the answers are yet known, but it will help to identify where the bear traps are.

Geoff Whittaker