



HM Revenue
& Customs

Business Premises Renovation Allowances

Summary of responses

10 December 2013

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1. Introduction

Background

- 1.2 On 18 July, following a written statement by the Exchequer Secretary to the Treasury, David Gauke, HM Revenue & Customs (HMRC) published a Technical Note inviting comments from interested parties *“on possible ways in which the policy purpose underlying Business Premises Renovation Allowance (BPRA) might be made clearer in the relevant legislation, so that the scheme may be made simpler and more certain in its application, at the same time reducing the risks of exploitation”*.
- 1.2 The Technical Note contained proposals to:
- Limit ‘qualifying expenditure’ to actual works and directly associated services and restrict the relief available for project management fees.
 - Prevent tax relief being available unless the building has been unused for a year at the time the expenditure is incurred.
 - Prevent abuse brought about by “pre-paying” and claiming upfront tax relief on works not carried out for some time, if ever.
 - Introduce a targeted anti-avoidance rule (TAAR).
- 1.3 The Technical Note invited interested parties to respond to these proposals by 30 September 2013. This document summarises the comments received, and sets out the Government’s response and next steps.

2. Summary of responses to the Technical Note

- 2.1 A total of 31 replies were received in response to the Technical Note, ranging from BPRA scheme promoters, developers, wealth managers, accountants, law firms, a local authority and an MP.

BPRA 'qualifying expenditure'

Question 1: Would the legislative approach, set out at paragraphs 6.2 to 6.6, be effective in preventing attempts to include the value of elements, such as those outlined at paragraph 2.9, in claims to BPRA?

- 2.2 Whilst some respondents did not agree that all the expenditure mentioned in paragraph 2.9 should be excluded, the majority of respondents agreed that clarifying the expenditure that qualifies for relief would be an effective approach. Some respondents were of the opinion that legislation was not required and that clearer guidance would be sufficient.

Question 2: For greater clarity, should the legislation contain a provision to the effect that elements of the sort described at paragraph 2.9 are specifically excluded?

- 2.3 Some respondents expressed concerns about listing excluded activities on the grounds that this could lead to further exploitation and that qualifying expenditure must be judged on a case by case basis, whilst most respondents thought it desirable in general.

- 2.4 The responses to the individual proposals set out in paragraph 2.9 of the Technical Note were as follows.

- 2.5 *The benefits of pre-lettings or of a 'license fee' or guarantee of a certain level of rental income (to cover the 'build-out' period or potential future void periods), provided by the scheme developer or other scheme organiser;*

Most respondents disagreed with this proposal, suggesting that it is not unusual for a developer to pay a sum equivalent to rent by way of licence fee until such time as the rent under the occupational lease starts.

- 2.6 *The inclusion of a 'super profit' for the developer or other scheme organiser, reflecting the market value of a completed property investment, with no, or very limited, risks (as distinct from the normal profit margin a developer might charge for overseeing building works carried out by a contractor);*

Respondents did not agree that developers or scheme organisers make a "super profit", on the grounds that they play a significant role in BPRA schemes

and bear considerable financial risk. Respondents see any profit as a reward for that risk

2.7 The inclusion of amounts above both the costs of construction, and the value of a fully completed and let development, on the grounds that the value does not reflect the availability of BPRAs relief;

Four respondents disagreed, or expressed caution, suggesting that it is not unusual for the market value of a finished building in an assisted area to be less than the true cost of the renovation works carried out on it. Two agreed.

2.8 The inclusion of sums reflecting the costs of promoting the scheme to potential investors or of putting in place the financial arrangements or other fund-raising activities.

Seven respondents considered that these costs should be included. One agreed that they should be excluded.

2.9 The inclusion of expenditure that does not comprise "qualifying expenditure" under the BPRAs rules, such as:

The attribution of a disproportionate amount of the overall investment to renovation costs, rather than to the (non-qualifying) cost of the site and existing building;

Respondents agreed that land should be excluded.

2.10 The costs of a tenant's fit-out to include non-qualifying chattels;

Six respondents agreed that chattels should be excluded. Two thought legislation unnecessary and two expressed caution about the type of chattel that might be excluded.

2.11 The costs of incentives given to a tenant by the scheme developer to take a lease at a certain level of rent;

Seven respondents disagreed considering the costs necessary. Two agreed.

2.12 Expenditure on a building that is, technically, to be used as a dwelling' (for example, student flats) and which does not, therefore qualify as 'business premises' for BPRAs purposes (s.360D(1)(c) Capital Allowances Act 2001 (CAA) refers).

Many respondents agreed that dwellings should be excluded; some considered legislation unnecessary as they are technically already excluded under the existing legislation. Two respondents suggested that student accommodation, and one respondent specialist live-in high street units, be considered for inclusion on the grounds that this can add to the economic activity of an assisted area.

Question 3: Would this approach also be effective in deterring the use of circular, limited-recourse borrowing arrangements? If not, please give reasons for your views.

- 2.13 While some respondents agreed this approach would be effective, many respondents suggested that existing anti-avoidance rules, case law and the existence of the €20 million expenditure cap¹ in respect of individual projects, deters large scale abuse.

Question 4: Assuming that the new legislation should provide a cap in relation to the amount of any developer's fee, where one is charged (that is, to allow such a fee, whilst preventing potentially excessive claims for BPRAs) - do you consider that there should be consideration of the circumstances, and that, in any event, 5 per cent of the total sub-contacted costs, would provide a fair maximum amount, on which BPRAs tax allowances should be allowed?

- 2.14 Most respondents did not agree that such fees should be capped at five per cent, many suggesting that levels of between 15 and 30 per cent were reasonable. One suggestion was that the developer's margin should be limited to 100 per cent of the refurbishment costs, or 50 per cent costs including all refurbishment, property, financing, or limited to 30 per cent of the total fund size, subject to market values.

Timing issues

Question 5: Would the legislative approach (as outlined at paragraph 6.8) proposed to counter the timing issue provide an effective deterrent?

- 2.15 Many respondents agreed that relief should not be given on later works contingent on the success of earlier projects, but most did not agree that such a time limit should apply where there were no such contingencies, because advance payments can provide certainty that funds are available to lenders and contractors and give investors certainty that they will get tax relief immediately.
- 2.16 Should a time limit be introduced, the majority of respondents considered 12 months to be too short. Suggested alternative time limits were between 24 and 48 months.
- 2.17 A number of respondents also addressed the 12 month period that buildings must be left unused in order to qualify for the relief. Eight agreed that the 12 month period was appropriate. Four either disagreed, because it impacts on developments comprised of used and unused developments, or were of the opinion that the existing legislation does not give this effect.

¹ The expenditure cap was introduced in 2012 to comply with State aid rules and limits the expenditure that qualifies for BPRAs to €20 million per individual project.

Specific BPRa measure – general questions

Question 6: Do you consider that there would remain ways in which the new legislation, proposed to clarify BPRa’s policy purposes, could be exploited or circumvented? If so, please indicate how, and also how such attempts might be addressed

- 2.18 The majority of respondents thought that based on the proposals any new legislation would prevent exploitation, but that the revised legislation would need to be considered before reaching a final conclusion.

Question 7: Conversely, do you consider that there are circumstances in which the proposed new legislation would give rise to outcomes inconsistent with BPRa’s policy objectives? (Bearing in mind that these objectives include value for money for the Exchequer.) If so, in what circumstances and how might these situations be addressed?

- 2.19 Most of those respondents that answered the question, were concerned that the changes might reduce the incentive value of BPRa, making some future investments less attractive.

A targeted anti-avoidance rule (TAAR)

Question 8: Do you consider that a TAAR in relation to Property Business Loss Relief with a ‘capital allowances connection’ would be a sensible and effective deterrent to other potential forms of BPRa exploitation?

- 2.20 Eighteen of the respondents considered a TAAR unnecessary being of the opinion that the general anti-abuse rule was adequate, or that existing case law provided sufficient protection. It was felt that a TAAR would complicate rather than clarify. Three thought that a TAAR was necessary or possibly necessary.

Difficulties of raising finance

- 2.21 A number of respondents engaged in promoting and developing BPRa schemes stated that BPRa schemes are considered high risk, which makes raising finance from individuals difficult. For the same reason bank lending terms are often unfavourable. In addition, because BPRa investors often limit their risk through limited liability partnerships, the lending banks often require guarantees from scheme promoters or developers.

Length of the investment

- 2.22 A number of respondents suggested that the seven year period that a building must be held in order to prevent a balancing charge was too long for most investors. It was suggested that this period be reduced to three to five years.

Has the scheme been a success?

2.23 Some respondents commented that where BPRA schemes had been entered into they had generally been successful. Two respondents considered that the relief has failed to achieve more than limited regeneration, as it has been heavily weighted towards hotel developments in key city centre locations, where the commercial risks are low.

3. Government response

- 3.1 The Government is grateful for the responses received to HMRC's BPR Technical Note; which will also be taken into account when considering the future of BPR after April 2017 (its present end date). The proposals set out in that Note have been considered carefully in the light of the comments received, and the Government's response is set out below.

Qualifying expenditure

- 3.2 The Government is committed to the objectives of BPR, but remains of the view that BPR was designed to give relief only for the actual direct costs of converting or renovating an unused business premises to bring it back into business use. As a number of respondents mentioned, the general principle of capital allowances is that relief is given on expenditure incurred on the provision of a qualifying asset, rather than the means of acquiring that asset, e.g. arranging finance, and the Government's view is consistent with that.
- 3.3 Those respondents who considered that the relief extends to expenditure incurred on, for example, arranging finance or attracting tenants, attempted to justify this by referring to the associated risks and difficulties of raising finance or attracting tenants to properties located in assisted areas.
- 3.4 But capital allowances are not designed to relieve risk or difficulties, they are designed as a proxy to replace depreciation or, as in the case of BPR, to incentivise certain activities, such as the refurbishment of unused buildings in assisted areas. Risk and difficulties are present in many income deriving activities, but no overwhelming reason was given why in the case BPR projects such risk should exceptionally be mitigated through the capital allowances system.
- 3.5 Some respondents suggested that by limiting qualifying expenditure, the value of the incentive will be reduced. However, those respondents appear to have based this view on the belief that BPR is designed to relieve a wide range of expenditure, e.g. the cost of raising finance or attracting tenants.
- 3.6 The Government believes that BPR offers a valuable incentive as it not only relieves expenditure that would ordinarily be irrecoverable, i.e. to the fabric of the building which can amount to around 30 per cent of the costs, but also accelerates expenditure on certain items of plant and machinery that would ordinarily be written down at a much lower rate.
- 3.7 A number of respondents suggested that instead of legislative change, better guidance would be sufficient. However, as many respondents do not agree that BPR applies only to the direct building costs of converting or renovating qualifying buildings, enhancing existing legislation would not prevent future disputes.
- 3.8 Consequently, the Government has decided to amend the existing legislation to make the scope of the relief more certain in its application.

Defining qualifying expenditure

3.9 In order to make the scope of BPRA clear, the definition of qualifying expenditure will be clarified to make clear that only the costs of the actual works of renovation, conversion or repair, i.e. labour and materials, will be eligible for relief. Relief will also be provided in respect of certain named associated activities:

- Architectural and design services, e.g. to cover the detailed (re)design of the building and its future layout.
- Surveying and engineering e.g. to include surveying services and detailed structural analysis of the building to cover issues such as asbestos or rot.
- Planning applications e.g. the costs of obtaining planning permissions to alter, for example, a listed building.
- Statutory fees and permissions e.g. to cover the costs of building regulation fees or obtaining statutory permissions, from utilities.

3.10 In addition relief for the costs of other associated activities, such as project management, will be allowed up to a limit of 5 per cent of the cost of the actual works of conversion, renovation or repair.

3.11 Although the majority of respondents considered this limit too low, this appears to be based on their view that a very wide range of expenditure qualifies for relief. As stated, the Government considers that BPRA is only designed to relieve the direct costs of construction and the evidence suggests that project management related services in respect of such works generally amounts to between two to five per cent of the construction costs, depending on the level of services provided. The Government does not dispute that costs and risks may be higher in relation to BPRA projects, but it has never been the intention that all costs will qualify for the relief and in the Government's opinion they are not relievable under the current legislation.

3.12 The Government considers that by clearly setting out the expenditure which BPRA is intended to relieve, the risks of exploitation will be much reduced, and the scope of the scheme will be more precise allowing taxpayers to identify qualifying expenditure more easily.

Rule to limit inflationary expenditure

3.13 In order to prevent arrangements being put in place in an attempt to inflate the relief claimable, qualifying expenditure incurred in carrying out the works will be limited by reference to the market value (or price) of the works.

Fixtures

- 3.14 It was agreed by respondents that chattels should not qualify for relief. In order to prevent abuse, the rule at section 360B(3)(d) CAA will be clarified by linking it to items of plant and machinery that are integral features for the purposes of section 33A CAA.

Timing issues

- 3.15 In order to ensure that relief is not available for "pre-payments" made for works that might never be made, or to maximise up-front tax relief, the Technical Note proposed that works attributable to any particular tranche of expenditure should be completed within 12-months of the expenditure being incurred.
- 3.16 Respondents explained that large upfront payments are often made to provide certainty to the banks and contractors that funds are available and to enable investors to claim immediate tax relief. However, the Government does not believe that it provides good value for money to give relief for upfront payments where the regeneration work may not be carried out for many years, if at all
- 3.17 Nonetheless, in light of the responses, the Government acknowledges that 12-months may be too short and has decided that on balance it is appropriate that works should be completed within 24 months of the expenditure being incurred, before action is taken to recover relief on expenditure that has not been spent within that period.
- 3.18 The present legislation also provides that expenditure only qualifies for relief if it has been incurred on a building that has been unused for a least one year. A number of respondents commented that the legislation did not give this result. Whilst disagreeing, the Government has decided to clarify the legislation to put it beyond doubt that expenditure incurred on a building that has not been empty for a year does not qualify for relief.

A targeted anti-avoidance rule (TAAR)

- 3.19 The Government considers that clarifying the expenditure that qualifies for BPRA reduces the risk of exploitation to the extent that a targeted anti-avoidance rule is unnecessary at this time.

Seven year period for which a building must be held

- 3.20 A number of responses referred to the seven year period a building must be held from first use, or suitability for letting, in order to prevent relief claimed being clawed back and suggested that this period be reduced to three to five years, to align with the holding period for venture capital trusts.
- 3.21 The seven year period was chosen to represent an equitable balance between providing a tax-based incentive to renovate empty buildings and recognising that a property owner may not wish to retain such property indefinitely. It also prevents abusive practices.

3.22 The Government has decided that there is merit in reducing the holding period to five years. It also aligns with the holding period for Venture Capital Trusts

4. Next steps

- 4.1 Legislation will be introduced in Finance Bill 2014 to make the changes outlined in Chapter 3 of this document. The changes will take effect for expenditure incurred on or after 1 April 2014 (for businesses within the charge to corporation tax) or 6 April 2014 (for businesses within the charge to income tax).
- 4.2 Draft Finance Bill 2014 legislation is published today alongside Explanatory Notes and a Tax Information and Impact Note. Comments on the technical detail of the legislation should be sent to Nick Williams, HM Revenue & Customs, CTISA CT and Business Income Tax, Room 3/64, 100 Parliament Street, London SW1A 2BQ. Telephone 03000 585660 Email: caguidance.ct&vat@hmrc.gsi.gov.uk by 4 February 2014

Annex A: List of respondents

There were 31 responses to the Technical Note, these included:

Regent Capital
B&M Tax Accountants
Ashall Projects
Squire Sanders
CA4
FTI Consulting
Grant Thornton
Middlesbrough Council
Adducere
Focus wealth
CIOT
McClure Naismith LLP
Yorkset Managers 1 Ltd
Scion
Cannock
PWC
Deloitte
Scodie Deyong Financial Services LLP
Capitus
BPF
Fladgate LLP
Gleeds
ICAEW
Percor Capital
London Society of Chartered Accountants
Harcourt Capital LLP
Davis Langdon, an AECOM Company
Downing LLP
DWF
CBRE Ltd

There was one Individual response.