Practice guide
Section 198 elections for plant fixtures

SPEED READ **When plant is sold a disposal value must be brought into account. This may be calculated using a 'just and reasonable apportionment', or for fixtures, a Capital Allowances Act 2001 s 198 election. Sellers should generally seek to agree as low an election amount as possible (eg, tax written-down value or say £1). However, buyers should usually avoid elections at less than the full amount of the seller's claim. There are various technical conditions necessary to make an election, but the greatest practical difficulty normally arises from providing information sufficient to identify the plant, and quantifying the value of fixtures.**

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Disposal values generally

When assets that have qualified for capital allowances are disposed of a 'disposal value' must be entered in the tax computation. This cannot exceed the taxpayer's claim for that plant (CAA 2001 s 62). CAA 2001 deals with disposal values for plant generally at s 61 and for fixtures at s 196.

Establishing disposal values can be complicated when buildings are sold because the proceeds relate to a combination of assets. Some may qualify for capital allowances, but could be chattels (that is, loose) or fixtures that are subject to the rules contained in CAA 2001 Chapter 14 (ss 172–204). Additionally, many assets will not have qualified for plant allowances. These include land (s 24), buildings and structures (ss 21-22), or the 'premises' in which the business is carried on. Also, the seller may not have claimed capital allowances for all of the qualifying plant – this is surprisingly common. So how should the disposal value be calculated? There are two permissible ways:

- Section 562 'just and reasonable apportionment' of the sale price; or
- Section 198 election.

An apportionment is the default approach for all plant. This aims to reflect the value that each constituent part makes to the whole. CAA 2001 does not specify how this is done so it is a specialist tax valuation exercise. Unless the property is sold at a loss or plant is scrapped, an apportionment will normally result in a full claw-back of allowances claimed. What is never permissible (irrespective of the parties' wishes), but frequently happens in practice, is simply to make (a normally arbitrary) written allocation in the sale and purchase agreement, without this being based on a proper apportionment, or ratified by a valid s 198 election.

Section 198 and 199 elections

The second method enables the seller and buyer to jointly assign an amount to plant fixtures by entering into a s 198 election (or its s 199 lease equivalent). This allows the parties to agree the transfer value of those fixtures (that is, it becomes a commercial matter for negotiation). Making an election has no effect on capital gains tax. Importantly, an election is only possible for fixtures (not chattels). A disposal value is also only required for assets upon which the seller has actually claimed capital allowances (s 64). So a vendor who is outside the charge to tax, or whose expenditure is on trading account (eg, a trader-developer) cannot make an election. In these circumstances an apportionment is required.

Rationale for elections

When s 198 elections were introduced the 'spin' was that they would remove the 'burden and expense' of making an apportionment (*Tax Bulletin 35*).

However, in practice, apportionments are still routinely required to value chattels and fixtures upon which a prior owner has not claimed capital allowances. A planning opportunity and topical example of the latter is integral features, which are now designated as plant by s 33A, but would not previously have qualified in the hands of most taxpayers (eg, general electrical power and lighting, cold-water systems or external solar shading). Also, if an election is planned, there are still costs involved in understanding the capital enquiry replies, agreeing the election form and amount, and implementing it.

Tactical considerations

Section 198 elections are useful for sellers seeking to minimise any claw-back of allowances claimed. In the hope of the buyer agreeing to this, it is normally sensible to market property by specifying in the sale particulars and heads of terms that capital allowances will be retained. The contractual objective is then to agree as low a disposal value as possible. Two commonly proposed amounts are:

- Tax written-down value – this permits the seller to keep the benefit of writing-down allowances already obtained. It looks 'neutral' but is not because all allowances should normally transfer to the buyer, as discussed above; or
- £1 – even better from the seller's point of view because it permits retention of practically all of the future tax benefit.

However, for buyers the opposite applies and an election at less than the seller's full claim for fixtures is generally inadvisable unless adequate compensation is received elsewhere in the deal. This is because without an election, most, if not all, of the capital allowances would normally automatically transfer to the buyer. However, sellers will inevitably push for a much lower amount, so negotiated compromise is likely to result in a buyer losing relief. Plus a buyer may have to prepare an apportionment in any case to value any chattels, newly qualifying integral features and fixtures for which the seller has not claimed.

Ultimately, however, elections are a commercial matter and a purchaser may feel on balance that the loss of some capital allowances is a price worth paying to buy the property in question; the risk being that

disagreement may delay or jeopardise the transaction.

Technical considerations

Section 198 elections must be made by notice to HMRC no later than two years after the completion date of the sale and purchase. A copy should accompany both parties' tax returns for the first period in which the election has effect (normally when the transaction occurred). Section 201 sets out other things that elections should state, namely: the amount (which must be quantified when the election is made); the name of each of the persons; information sufficient to identify the plant; information sufficient to identify the 'relevant land' (ie, the building or land that the fixture is part of, s 173); particulars of the legal interest acquired, and the persons' tax district references. Regarding the amount, this must not exceed the seller's original expenditure on the fixture, or the total sale price for the entire property. It is automatically reduced if it subsequently proves too high. There is no minimum, but £1 is often proposed by hard bargaining sellers. Elections are irrevocable (s 200), so affect all future purchasers of the same fixtures, but it is possible to elect for lower amounts if that plant is later sold. Significantly, capital allowances claims (and hence disposal values) are for 'qualifying *expenditure*' (s 11). If plant fixtures (eg, a hot-water system) are later stripped out, then a disposal value (eg, scrap value or nil) must brought into account by the owner at the time and a further claim may be made for any new expenditure on a replacement system. That replacement expenditure would fall outside any pre-refurbishment election mentioning hot water because the election related to a separate, earlier tranche of qualifying expenditure (albeit on a similar asset to the replacement expenditure).

Most of the other conditions should present little practical difficulty, but mistakes do occur. For example, elections that do not state the name, address, or title number of the property, so fail to identify the relevant land as soon as they became separated from the sale contract of which they were part.

Information sufficient to identify the plant and machinery

Perhaps the greatest practical difficulty relates to the obligations to provide 'information sufficient to identify the plant' and quantify the 'amount fixed' (only for fixtures upon which the seller has actually claimed).

Chapter 14 provides a 'comprehensive code' for fixtures (*Melluish v BMI (No 3) Ltd* [1995] STC 964). It speaks of fixtures in the singular tense (that is, 'a fixture'). Therefore, the rules 'work on an asset-by-asset basis', but by concession, HMRC Inspectors 'may accept a *degree of amalgamation* of assets where this will not distort the tax computation' (*HMRC Capital Allowances Manual* para 26850). However, that does not remove the statutory obligation to identify each individual fixture; it merely removes the need to prepare a separate election for each. And presumably a taxpayer can insist that a valid election may only be made on the true statutory basis. HMRC's requirement not to distort the tax computation does mean that where plant qualifies for writing-down allowances at different rates (eg, main pool qualifying at 20% and integral features at 10%) it will be necessary to distinguish between them. So two disposal amounts will be appropriate. But this will not be possible for integral features that qualify for the first time; including these risks invalidating the entire election. HMRC has never regarded it as reasonable to accept an election covering all the fixtures for a portfolio of properties, but I have even seen one election for a portfolio of properties owned by a number of associated companies!

Listed below are examples of misguided attempts to identify the plant. In my opinion all of these engender doubt about whether they meet the statutory obligation to identify on an asset-by-asset basis only the fixtures upon which the seller has actually claimed, or fail to quantity the value of plant fixtures (rather than chattels, or non-plant fixtures, or both):

- The description 'all fixtures', 'all fixed plant' or equivalent wording. This is commonplace, but lazy and imprecise. It either purports that the seller submitted a perfect claim for every conceivable plant asset (which is improbable), or fails to identify just the fixtures for which a claim was actually made;
- Attaching a (it is hoped, exhaustive) standard list of fixtures which may be found in a commercial building (normally without values against any of the descriptions), but which may or may not be present in the actual property, or upon which the seller may or may not have claimed capital allowances, or both;
- Combining the two examples above by referring to 'all fixtures at the property, including but not limited to' the standard list mentioned above;
- Enclosing an inventory of 'fixtures and fittings' that typically includes both fixtures and chattels. This muddles legal concepts because only 'fixtures' have a specific real estate law meaning and are subject to Chapter 14, so may be included in s 198 elections. If the election purports to relate to fixtures and chattels, with no separate amounts, then the amount allocated to the fixtures is not clear and the value cannot be said to be quantified. Therefore, the entire election must be invalid;
- The election purporting to cover assets that do not actually exist (eg, lifts in a single-storey building). The election is surely ineffective for similar reasons to the example immediately above.
- Mentioning assets that appear to be ineligible (broadly, assets that are not accepted as plant), invalid for the same reason.

Instead, preferably the election should list in as much detail as possible only the fixtures upon which capital allowances have been claimed by the seller (with amounts against each, where appropriate). At the least this should be amalgamated at 'elemental' level (eg, sanitary appliances, hot water system etc). Where a detailed capital allowances analysis has been prepared to substantiate the seller's original claim this should be straightforward to do. ■