

ACCURATE MANAGEMENT

The latest developments in capital asset management

When mentioning Capital Histories, many tax practitioners immediately think of share portfolios and the delights of Part IV of Taxation of Chargeable Gains Act 1992. Everyone appears comfortable with the notion that to calculate correctly the tax on share portfolios it is necessary to build up a history of exactly what has happened to each shareholding for tax purposes over time. The best way to do this is to maintain the records on a regular basis. Why then, does this simple principle appear to be at best, given cursory attention and at worst ignored until the very last minute, when it comes to other assets, in particular buildings and fixtures?

This paper therefore highlights the need for companies to build and maintain records arising from transactions on property and other large assets that are more accurate.

Recent changes to accounting standards such as International Accounting Standards 12, 15, 16 and 17 now require greater detail and organisation of asset data. Furthermore, the claiming of tax relief on expenditure relies on better record keeping not only on acquisition, but also on disposal.

To fully exploit the tax allowances and reliefs available, one needs to know what has happened and when. This is even more important when dealing with complex projects, such as commercial property development where a range of taxes and legislative provisions interact at various times during the life of the project. In cases such as this, keeping track of what has happened and having the most up to date information readily available can be the most valuable part of managing the post tax cost of any such project. However, it can also prove to be the most onerous part of the work undertaken by internal and external tax advisers.

Fixed asset registers

Most companies rely almost exclusively on their fixed asset registers to act as the repository of data on asset purchases. However, it is probably of limited surprise to most tax practitioners in large companies to learn that the data kept in their systems is almost certainly inaccurate. A survey carried out by Davis Langdon Crosher & James in 2004 revealed that over 85% of companies could not quickly reconcile the total cost of a construction project with the data in the fixed asset register.

There is a variety of explanations for this mismatch, but the prime reason is the low level of detail provided to the accounting staff who input the data. There is often a tendency to lump costs together as either land and buildings, or as fixtures, when in fact the invoice needs separating into a number of categories. Further complications are invariably caused by trying to use data from software designed to calculate asset depreciation rather than optimise the tax position.

Statistical Sampling

As companies have grown, the problem of having accurate data to deal with the tax consequences of acquisition, refurbishment or disposal of large assets has become more significant. The recent accounting scandals of Enron and Parmalat and the ongoing adoption of international accounting standards have put a lot more pressure on finance departments to get their accounting for assets correct.

A solution adopted by many companies, particularly those with a large portfolio of property interests such as retailers, is to agree their capital allowances entitlement based on an agreed proportion of the total expenditure incurred during the financial year. This mechanism has the advantage of simplicity, saving both time and money when dealing with what is often a complex problem. There is, however, a cost to such a process as HM Revenue & Customs have become increasingly cautious about such agreements, and will always ensure a margin of error in its favour. Some businesses are moving away from percentage-based agreements and are becoming increasingly interested in using the database programs that have been launched onto the market in the last few years.

Database software

The advantage of such database systems is that they create a repository for data on capital assets that provides comprehensive information for both tax and accounting purposes. The key difference is that for the first time database systems are being developed primarily to create accurate tax data rather than merely acting as a bridge from, or an extension to, the existing accounts system.

For most businesses, the information required for tax decisions is invariably held in a myriad of accounts systems, spreadsheets, databases and documents, either electronic or paper. The latest developments in data extraction and data transformation technologies allow this tax knowledge to be collated and centralised to help create the tax database. This then moves the tax manager significantly closer than in the past to being able to provide true benchmark figures for projects, statistical and exception reporting for the board and detailed, auditable figures to back up any computation submitted to HM Revenue & Customs, all quickly and effectively.

The people factor

Irrespective of the brilliance of a software solution, any system will fail unless attention is paid to the old adage 'garbage in, garbage out'. The problem with collection of data on assets such as buildings is that it rarely comes in the form required for tax purposes. A common example would be an allocation of costs on interim payments made to a building contractor through the course of a construction project. The application for payment is usually a single lump sum for the work that is done to date. The contractor has no interest in separating costs into different asset categories. Furthermore, it must be recognised that there is a peculiar tendency for most professionals working in

the UK property or construction industry to actively avoid any involvement in tax matters, largely through fear of the complexity of our taxation regimes. Unless the systems put in place to collect data make it easy for contractors, surveyors or project managers to provide information in the format required, then the systems will provide inaccurate results.

Similarly, database design is crucial to make data entry as simple as possible. Property related tax data requires so many reference points that one might have to put in as many as fifteen entries to register a single invoice. Past attempts to design property taxation database systems have failed as they have been inflexible and it has been simply too slow to input the data. For such systems to work, they have to be easy for people to use.

Maintaining the data

If one starts down the road of building detailed capital histories for an asset portfolio, there has to be commitment from all parties to maintaining that information. It is all too easy for a system to fall into disrepair. Effective automated data feeds from the ledger systems need to be put in place to allow the upload of relevant information on a monthly or quarterly basis. Procedures also need to be put in place to ensure that all interested parties know their responsibilities. For example, the surveyors, at the same time as approving an interim or milestone payment, should be using the capital history system to update the details for the tax adviser to analyse.

Once the appropriate systems are in place, recording the relevant decisions, agreements and facts to support your capital allowances claims and capital gains tax computations going forward becomes a straightforward part of the process.

Business Intelligence – making the most of the information

One of the most important aspects of the continuing management of capital projects and histories is to highlight issues and potential planning points as they occur. This can be achieved by the tax adviser reviewing relevant expenditure on a regular basis and making the appropriate tax decisions. A complete review of all expenditure is not a practical proposition in most cases, but a comprehensive system would at least allow configurable exception reporting and make certain default decisions for you based on particular ledger account codes or supplier codes.

Easy access to the relevant facts has also to be considered in the context of the interaction of taxes. When reviewing expenditure, the interaction of for example, capital allowances and capital gains tax, is vitally important for capital projects. Many people remain unaware of the most generous double tax relief available, enshrined in section 41 Taxation of Chargeable Gains Act 1992, that allows capital allowances and capital gains tax relief to be claimed on the same expenditure, subject to a restriction if a capital loss arises on the eventual disposal.

By ensuring that any system in place allows the capital allowance and capital gains treatment for expenditure to be clearly recorded, it then becomes a simple process to undertake “what if?” plans that offer assurance that no aspects are being ignored. Such abilities can then even go so far as to produce net present value calculations to determine the post tax value of a project taking into account allowance claims over time, an estimated future disposal value and any resultant gain. In addition, accounting requirements such as deferred tax and contingent gains reporting are made far simpler.

If the system allows for documents such as agreements, planning approvals, design briefs and site plans to be attached to the asset records, then one can build a complete picture of what has happened on which to base decisions. This proves useful when, for example, a commercial property is built and then disposed of and the vendor and purchaser wish to enter into an election under section 198 Capital Allowances Act 2001 to agree the disposal value of the fixtures in the property. To preserve allowances claimed, the vendor will want the lowest possible value, but the reality is that there will be some horse trading involved in negotiating the disposal value. However, if the exact figures for fixtures are to hand, as part of a full analysis of the property history, ones negotiating position is considerably strengthened.

Not so daunting

In many circumstances, it can seem daunting to approach the cost segregation of capital projects in any more than a broad brush, percentage based approach. However, the benefits from undertaking a proper analysis of expenditure for capital taxes purposes and building up a history for each asset gives a strong basis on which to build planning decisions and provides assurance to the authorities that one is dealing with the matter seriously. Only recently have the business intelligence tools been available to make this type of analysis possible so now could be the time to meet the challenge and move forward. With the right mix of technology and process design, this is no longer an arduous prospect.

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