# Allowances for Energy Efficient Equipment

Gordon Brown likes to use the tax system to make the world a better place. One of his aims is to encourage businesses to be more energy efficient using the old carrot and stick routine. The Climate Change Levy is definitely a tax stick imposing an additional charge on business users of most types of energy as explained in Allison Plager's article 'Climate Change Levy: Steam Heat' in *Taxation*, 7 September 2000 at page 593, while Enhanced Capital Allowances are the less well known carrot.

Enhanced capital allowances are 100 per cent first year allowances given on the purchase of qualifying plant or machinery. The scheme was introduced by section 65 and schedule 17 of the Finance Act 2001, and has recently been expanded by Finance Act 2002, section 62. This article will not cover the separate 100 per cent first year allowances for low emissions cars and equipment for delivering liquid petroleum gas, introduced by sections 59 and 61, and schedules 19 and 20 of the Finance Act 2002, as those 'green' incentives will be the subject of a future article.

**Qualifying equipment**

To qualify for an enhanced capital allowance the equipment must be classified as plant or machinery under the part 2 of Capital Allowances Act 2001 and it must be purchased new and unused on or after 1 April 2001. In common with other first year allowances some general categories of asset are excluded from the allowance, such as cars, ships and railway assets. However what is unusual about enhanced capital allowances is that only items of equipment in specified technology categories (see Table 1) and which are also included on the Energy Technology List, or meet other criteria, can be included in a claim. The Energy Technology List can be interrogated through the enhanced capital allowances website: www.eca.co.uk, or via the Action Energy line (see contact details).

**The Energy Technology List**

The Energy Technology List is ostensibly under the control of the Department of Environment, Food and Rural Affairs (DEFRA) but it's maintenance has been outsourced to the Carbon Trust, a not for profit company.

To have a product included on the Energy Technology List the manufacturer must complete an application either online at www.eca.co.uk, or on a paper form which can be obtained from the Carbon Trust, (see contact details). The application must include the product specification and evidence of appropriate internal testing procedures to prove that the product passes the required energy efficiency criteria. Each product type has a different set of eligibility criteria, which are listed on the website and included in the producers pack distributed by the Carbon Trust.

> ***Example***
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> Condensing economisers are heat exchangers that raise the fuel efficiency of boilers. For a condensing economiser to qualify the manufacturer must demonstrate that it increases a boiler's fuel efficiency by at least 9%.

If the Carbon Trust is satisfied the product meets the criteria it will send the manufacturer an acceptance letter. This confirms the product qualifies for an enhanced capital allowance from the date of the letter. If the product is rejected the

Carbon Trust will provide reasons for the decision and invite the manufacturer to resubmit the product with further information if necessary. The whole application process takes about 30 days, and the Energy Technology List is updated each month with the details of newly approved products.

The Carbon Trust regularly selects products at random from the Energy Technology List for independent testing to confirm their energy efficiency claims. The manufacturer is informed that testing is to be carried out but the Carbon Trust pays for the initial test. If the product fails this first test the manufacturer is requested to submit the product for further testing at his own expense. A second test failure will mean the product is removed from the Energy Technology List. If the product passes the second test the manufacturer can reclaim the costs incurred from the Carbon Trust.

**Technology Categories**

There were initially seven categories of technologies within the Energy Technology List from 1 April 2001, (see Table 1, nos. 1-7) which were defined by statutory Instrument SI 2001/2541. Four additional categories (Table 1, nos. 8-11) were added by SI 2002/1818 with effect from 5 August 2002. Further categories of technologies can only be added by regulation but the types of products listed within the categories are regularly added to, withdrawn or combined with other product descriptions as a result of consultations with manufacturers.

> ***Example***
> Refrigeration display cabinets were added as a new product type within the refrigeration equipment category from 5 August 2002.

The Government is currently consulting on proposals to include new categories of technologies concerned with improving water quality and reducing water use with effect from a date in 2003.

**Lighting and pipe insulation**

Products within these technology categories do not have to be separately included in the Energy Technology List. As long as the supplier or installer can confirm that the products and method of installation meet the energy saving criteria of the relevant British Standard, the equipment will qualify for enhanced capital allowances.

> ***Example***
> Pipe-work insulation must meet the British Standard BS 5422.

**Combined heat and power (CHP)**

Combined heat and power plants are large installations that generate electricity and use otherwise wasted heat. The expenditure on such plants can only qualify for enhanced capital allowances if a certificate of energy efficiency has been granted for the plant at the design stage. Such a certificate may be revoked with retrospective effect if the plant it does not comply with the energy saving criteria required by the Combined Heat and Power Quality Assurance program. In this case the enhanced capital allowance would not be due and the taxpayer must revise the capital allowance claim on his tax return within three months of becoming aware that the return is incorrect, (section 45B(4), Capital Allowances Act 2001).

**The claim**
A claim for enhanced capital allowances should not be open to challenge by the Inland Revenue, with the rare exception of claims relating to a combined heat and power plant with a revoked energy efficiency certificate. If the exact make and model of equipment is on the Energy Technology List at the date of purchase, or the supplier has certified that the lighting or pipe insulation complies with the relevant British Standard, then the enhanced allowances should be due.

However the Revenue still have a few difficulties with enhanced capital allowance claims for lighting equipment, which is not generally regarded as plant unless it is required to meet the particular demands of the trade, or to serve plant or machinery used in the trade, (item 2 in List C section 23, Capital Allowances Act 2001). In the guidance note on enhanced capital allowances (see the Inland Revenue website: http://www.inlandrevenue.gov.uk/capital_allowances/eca_guidance.htm), the Revenue provide several examples of when a lighting system, or part of the lighting system can be regarded as plant. In each case the taxpayer must be able to show that the lighting is installed specifically for his trade and is not general lighting for the building.

The taxpayer should make his a claim for enhanced capital allowances based on the Energy Technology List as it stood on the date the product was purchased. It is possible to search the Energy Technology List on the website: www.eca.co.uk to see if a particular product was included on the list on the acquisition date. If the product is subsequently removed from the Energy Technology List because the product fails the random energy efficiency tests (see above) the taxpayer does not have to revise his capital allowance claim.

**The amount to claim**
A claim for enhanced capital allowances should include the net price paid for the equipment plus any transportation or installation costs, plus the expense of necessary alterations to the existing building to hold the equipment and any direct professional fees such as an inspection to confirm the equipment has been correctly installed and is safe to operate. If the energy efficient equipment is incorporated into a larger machine that does not qualify on its own account for enhanced capital allowances, the taxpayer can claim a proportion of the cost of the machine. The Energy Technology List includes acceptable cost proportions for all approved components, which can be searched for on the ECA website under 'claim values'.

**Table 1:**

| There are eleven categories of technologies in the Energy Technology list: |
|---|
| 1. Combined heat and power systems (CHP);<br>2. Lighting;<br>3. Pipe insulation;<br>4. Boilers;<br>5. Motors and drives;<br>6. Refrigeration equipment;<br>7. Thermal screens;<br>8. Heat pumps;<br>9. Radiant and warm air heaters;<br>10. Compressed air equipment; and |

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|---|
| 11. Solar thermal systems. |

**Contact details:**
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All queries regarding the Energy Technology List can also be dealt with by the Action Energy line: 0800 58 57 94.

**Leasing**

Taxpayers are prevented from claiming first year capital allowances on assets acquired for leasing by section 46(2), Capital Allowances Act 2001. However section 62 of the Finance Act 2002 lifts this restriction from 17April 2002 for assets acquired on or after that date that qualify for enhanced capital allowances.

The Revenue are careful to distinguish in their guidance notes between equipment that is leased and equipment that is provided as part of an energy services agreement. The former will only qualify for enhanced capital allowances from 17 April 2002, but the later equipment can qualify from 1 April 2001. Under an energy services agreement the energy services provider operates and maintains the equipment which is installed in the customer's premises, to help the customer save energy. The equipment is deemed to belong to the energy services provider under section 180A, Capital Allowances Act 2001, so the energy services provider can claim the capital allowances due on that equipment.

**Open to all**

Enhanced capital allowances can be claimed by any size of business. This contrasts with the 40 per cent first year allowances normally available for plant and machinery that can only be claimed by small and medium sized businesses. Unlike the first year allowances for information and communications technology, which can only be claimed by small businesses for a limited period until 31 March 2003, the enhanced capital allowances are not time limited.

**Conclusion**

When enhanced capital allowances scheme was first introduced critics claimed that time would be wasted searching for approved products, evidence would have to be collected for every piece qualifying equipment, and the values of all those qualifying items would have to be assessed separately from the main bulk of plant and equipment. I believe these pessimistic predictions have proved to be incorrect.

The ECA website (www.eca.co.uk) provides a virtual exhibition to help buyers search for the types of products required from their desks. Manufactures are encouraged to use an Energy Technology List symbol on their promotional materials and invoices to identify qualifying products. If the product is not specifically identified the Energy Technology List can be quickly searched online for a particular product make and model. For those without fast access to the Internet a free telephone helpline puts you quickly through to real people who can search the list for you and answer a wide range of related questions. There should be no need to retain particular special evidence that a product qualified at the date of purchase as the Energy Technology List can be searched for acquisition dates in the past. All the qualifying products acquired in one accounting period can be grouped together in the capital allowances claim. If the full first year allowance is not required the balance of the cost can be claimed in subsequent years as a normal plant and machinery writing down allowance.

I do believe that the system could be simplified by expanding the definition of plant to include all lighting equipment. This would allow energy efficient lighting equipment that meets the qualifying criteria to be eligible for enhanced capital allowances without the additional hurdle of the relevance of the lighting system to the taxpayer's trade. When water efficient technologies are introduced in 2003 will a business have to prove that a water efficient toilet is necessary for the particular requirements of its trade in order to claim the enhanced capital allowance?