

Capital Allowances

The cost of purchasing capital equipment in a business is not a revenue tax deductible expense. However tax relief is available on certain capital expenditure in the form of capital allowances.

The allowances available depend on what you're claiming for. In this factsheet we give you an overview of the types of expenditure for which capital allowances are available and the amount of the allowances.

Capital allowances are not generally affected by the way in which the business pays for the purchase. So where an asset is acquired on hire purchase (HP), allowances are generally given as though there were an outright cash purchase and subsequent instalments of capital are ignored. However finance leases, often considered to be an alternative form of "purchase" and which for accounting purposes are included as assets, are denied capital allowances. Instead the accounts depreciation is usually allowable as a tax deductible expense.

Any interest or other finance charges on an overdraft, loan, HP or finance lease agreement to fund the purchase is a revenue tax deductible business expense. It is not part of the capital cost of the asset.

If alternatively a business rents capital equipment, often referred to as an operating lease, then as with other rents this is a revenue tax deductible expense so no capital allowances are available.

Plant and machinery

This includes items such as machines, equipment, furniture, certain fixtures, computers, cars, vans and similar equipment you use in your business.

Note there are special rules for cars and certain 'environmentally friendly' equipment and these are dealt with below.

Acquisitions

- Most businesses are able to claim an Annual Investment Allowance (AIA) on most plant and machinery. This provides immediate 100% tax relief on qualifying annual expenditure up to £50,000 until April 2010 and £100,000 thereafter (see detail below). There are regulations for commonly controlled businesses to prevent unjust multiple claims. It is proposed that the limit will be reduced to £25,000 in April 2012.
- Expenditure on all items of plant and machinery are pooled rather than each item being dealt with separately with most items being allocated to a general pool.
- A writing down allowance (WDA) on the general pool of 20% is available on any expenditure incurred in the current period not covered by the AIA or not eligible for AIA as well as on

any balance of expenditure remaining from earlier periods. It is proposed that the WDA is reduced to 18% in 2012.

- Certain expenditure on buildings fixtures, known as integral features (eg lighting, air conditioning, heating, etc), is only eligible for a 10% WDA so is allocated to a separate 'special 10% rate pool' It is proposed that the WDA is reduced to 8% in 2012.
- Allowances are calculated for each accounting period of the business.

Example 1

During the year to 31 March 2010, a medium-sized business buys plant and machinery costing £80,000, 50% of which would only qualify for WDA of 10%. There are no balances brought forward.

	£ General pool 20%	£ Special Rate pool 10%
	40,000	40,000
AIA 100%	(10,000)	(40,000)
Balance	30,000	0
FYA @ 40%	(12,000)	
Pool carried forward	£18,000	
Total allowances (£10,000 + £40,000 + £12,000)		£62,000

- The allowance is to increase to £100,000 from 1 April 2010 for a business within the charge to corporation tax and from 6 April 2010 for a business within the charge to income tax. This means that if the above business spends £80,000 as above in the year to 31 March 2011 100% relief will be obtained on the whole amount.
- As the chargeable accounting periods of many businesses will span the operative date of change, a pro rata calculation of their maximum entitlement will be required as demonstrated below.

Example 2

A company prepares accounts on a calendar year basis in 2010. The AIA available for the year to 31 December 2010 will be

$$3/12 \times £50,000 \text{ plus } 9/12 \times £100,000 = £87,500.$$

This can be used wholly in the period 1 April 2010 to 31 December 2010 but only £50,000 of the entitlement can be used for expenditure prior to 31 March 2010.

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Disposals

When an asset is sold, the sale proceeds (or original cost if lower) are brought into the relevant pool. If the proceeds exceed the value in the pool, the difference is treated as additional taxable profit for the period and referred to as a balancing charge.

Special rules

There are special rules for the treatment of certain distinctive types of expenditure. The first distinctive category is car expenditure. Other vehicles are treated as general pool plant and machinery but cars are not eligible for the AIA. The treatment of car expenditure depends on when it was acquired and is best summarised as follows:

Pre April 2009 acquisitions

Type of car purchase	Allocate	Allowance
Low emission car 110g/km or less	General pool	100% allowance as environmentally friendly
Not exceeding £12,000 cost and not low emission	General pool	20% (18% from 2012) WDA*
Exceeding £12,000 cost and not low emission	Single asset pool for each car	20% (18% from 2012) WDA but restricted to £3,000 maximum p.a.*

Cars purchased wholly for business use will attract the WDA above until disposal and are not affected by the changes to capital allowances on cars which commenced in April 2009. However any expenditure remaining in a single asset pool after a transitional period of around 5 years (unless there is any non-business use of the car) will then be transferred to the general capital allowances pool.

From April 2009

The capital allowance treatment of cars from 1 April 2009 for companies and 6 April 2009 for sole traders and partnerships is based on the level of CO₂ emissions only not the cost of the car.

Type of car purchase	Allocate	Allowance
Low emission car 110g/km or less	General pool	As above 100% allowance
Not exceeding 160 CO ₂ emissions	General pool	20% (18% from 2012) WDA
Exceeding 160 CO ₂ emissions	Special rate pool	10% (8% from 2012) WDA

Non-Business use element

Cars and other business assets that are used partly for private purposes, by the proprietor of the business (ie a sole trader or partners in a partnership), are allocated to a single asset pool irrespective of costs or emissions to enable the private use adjustment to be made. Private use of assets by employees does not require any restriction of the capital allowances.

The allowances are computed in the normal way so can in theory now attract the 100% AIA or the relevant writing down allowance. However, only the business use proportion is allowed for tax purposes. This means that a 109 CO₂ emission car which costs £15,000 with 80% business use will attract an allowance of £12,000 (£15,000 x 100% x 80%) whenever acquired.

On the disposal of a private use element car, any proceeds of sale (or cost if lower) are deducted from any unrelieved expenditure in the single asset pool. Any shortfall can be claimed as an additional one off allowance but is restricted to the business use element only. Similarly any excess is treated as a taxable profit but only the business related element.

Environmentally friendly equipment

This includes items such as energy saving boilers, refrigeration equipment, lighting, heating and water systems as well as cars with CO₂ emissions up to 110 g/km.

A 100% allowance is available to all businesses for expenditure on the purchase of new (not second hand) environmentally friendly equipment.

- www.eca.gov.uk gives further details of the qualifying categories.
- where a company (not unincorporated) has a loss after claiming 100% capital allowances on green technology equipment they may be able to reclaim a tax credit from HMRC (not cars).

Capital allowance boost for low-carbon transport

A 100% first year allowance will be available for capital expenditure on new electric vans from 1 April 2010 for companies and 6 April 2010 for an unincorporated business. This proposal is subject to European State Aid rules.

Short life assets (not cars or integral features)

For equipment you intend to keep for only a short time, you can choose (by election) to keep such assets outside the normal pool. The allowances on them are calculated separately and on sale if the proceeds are less than the balance of expenditure remaining, the difference is given as a further capital allowance.

The asset is transferred into the pool if it is not disposed of by the fourth anniversary of the end of the period in which it was acquired.

Long life assets

These are assets with an expected useful life in excess of 25 years are combined with integral features in the 10% pool. It is proposed that this rate will be reduced to 8% in 2012.

There are various exclusions including cars and the rules only apply to businesses spending at least £100,000 per annum on such assets so that most smaller businesses are unaffected by these rules.

Buildings

Limited capital allowances only are now available on certain buildings:

- industrial buildings
- agricultural buildings
- hotels.

There are no allowances on:

- the cost of land
- showrooms, offices and shops.

The rate of allowance is now only 1% for 2010/11 as these allowances are being phased out and this is the last transitional year.

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Enterprise Zone buildings

Commercial buildings in designated Enterprise Zones qualify for a 100% initial allowance. Where such zones still exist and the 100% allowance has not been claimed a 25% annual allowance is due. This will also be withdrawn in 2011.

Business property renovation allowance

100% capital allowances may be available for expenditure incurred on the conversion or renovation of qualifying business premises in disadvantaged areas. This commenced on 1 April 2007 and is set to last for 5 years.

Flats

A 100% allowance is available for the costs of converting redundant space over shops and offices into flats for short-term letting. The rules are complex and care must be taken to ensure that all of the necessary conditions are complied with.

Other assets

Capital expenditure on certain other assets qualifies for relief. For example:

- patents, specifically the expenditure on devising and patenting an invention, qualify for relief. For companies, the treatment of patents has changed from 1 April 2002. Capital allowances will not normally apply in respect of patent rights acquired on or after that date.
- research and development (R&D) qualifies for a 100% allowance. In some circumstances the relief can be claimed as R&D tax credit.

www.eca.gov.uk gives further details of the qualifying categories.

Claims

Unincorporated businesses and companies must both make claims for capital allowances through tax returns.

Claims may be restricted where it is not desirable to claim the full amount available - this may be to avoid other allowances or reliefs being wasted.

For unincorporated businesses the claim must normally be made within 12 months after the 31 January filing deadline for the relevant return.

For companies the claim must normally be made within two years of the end of the accounting period.

How we can help

The rules for capital allowances can be complex. We can help by computing the allowances available to your business, ensuring that the most advantageous claims are made and by advising on matters such as the timing of purchases and sales of capital assets. Please do contact us if you would like further advice.

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