



Capital Allowances

The cost of purchasing capital equipment in a business is not a revenue tax deductible expense but tax relief is available on certain capital expenditure in the form of capital allowances which replace the depreciation charged in your accounts.

In this factsheet we provide an overview of the types of expenditure for which capital allowances are available and the amount of those 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 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.

This factsheet outlines the rules for capital allowances for 2007/08 and 2008/09 due to significant changes between the two years and also the new capital allowance rules for cars from April 2009.

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.

Allowances to 31 March 2008 (5/4/08 for individuals)

- Small and medium-sized businesses (as defined for company law) can claim 40% (medium) and 50% (small) of the expenditure in the year of purchase - this is referred to as a first year allowance (FYA).
- Expenditure on all items of plant and machinery is usually included in a 'general pool' rather than each item being dealt with separately.
- A 25% allowance which is referred to as a writing down allowance (WDA) is

then available on any balance remaining, in future periods, or on any expenditure which did not qualify for first year allowances. This is therefore the main allowance for large companies.

- When an asset is sold, the sale proceeds (or original cost if lower) are brought into the 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.
- Allowances are calculated for each accounting period of the business.

Example

During the year to 31 March 2007, a medium-sized business buys plant and machinery costing £80,000.

A FYA of 40% is due and this amounts to £32,000. The balance to carry forward to the next period is £48,000 (being £80,000 less the FYA of £32,000).

In the year to 31 March 2008, plant is sold for £10,000 (original cost £14,000) and new machinery is purchased for £16,000. The allowances due are calculated as follows:

	£	£
Pool brought forward	48,000	
Less: Disposal	(10,000)	
	38,000	
WDA @ 25%	(9,500)	9,500
	28,500	
New machinery	16,000	
FYA @ 40%	(6,400)	6,400
	9,600	
Pool carried forward	£38,100	
Total allowances	£15,900	£15,900

Allowances from 1 April 2008 (6/4/08 for individuals)

- Each business irrespective of size will be able to claim a new 100% investment allowance for the first £50,000 (£100,000 from 1 April 2010) spent on plant and machinery. This will be available annually, and is known as the 'Annual Investment Allowance' (AIA). There are rules defining what constitutes a business unit to prevent unjust multiple claims.
- Expenditure on all items of plant and machinery will continue to be pooled rather than each item being dealt with separately.

- The writing down allowance (WDA) on the general pool is reduced from 25% to 20% but will be available on any expenditure incurred in the current period not covered by the AIA as well as on any balance of expenditure remaining from earlier periods.
- Certain expenditure on buildings fixtures (“integral features”) and some types of plant which are not covered by the AIA will only be eligible for a 10% writing down allowance and will be placed in a separate pool.
- When an asset is sold the sale proceeds (or original cost if lower) are brought into the 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.
- Allowances are calculated for each accounting period of the business. There are “transitional” rules for dealing with capital allowances where the accounting period straddles 1 April 2008, because elements of the old and new regime will apply.

Example

During the year to 31 March 2009, 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

	£ 20% pool	£ 10% pool
	40,000	40,000
AIA 100%	(10,000)	(40,000)
	-----	-----
Balance	30,000	0
WDA @ 20%	(6,000)	
Pool carried forward	£24,000	
Total allowances (£10,000 + £40,000 + £6,000)		£56,000

Special Rules

Cars

Environmentally friendly cars are included in the general plant pool	Other cars up to a cost of £12,000 are included in the general pool	Cars above £12,000 cost are not pooled but are dealt with individually
Pre 31 March 2008	Pre 31 March 2008	Pre 31 March 2008
100% allowable available, irrespective of cost where CO2 emissions 120gm/km or less on new cars	25% writing down allowance only	25% writing down allowance but restricted to a maximum of £3,000 annually. An extra allowance known as a balancing allowance is however claimed on any unrelieved expenditure on disposal.
From 1 April 2008	From 1 April 2008	From 1 April 2008
As above except the CO2 emissions now need to be at 110gm/km or less	20% writing down allowance only	As above except that the writing down allowance is computed at 20% and is then restricted to the maximum of £3,000.

Capital allowance changes to cars from April 2009

In the 2008 Budget it was announced there would be further changes to the capital allowances on cars from April 2009. These changes have effect from 1 April 2009 for corporation tax purposes and 6 April 2009 for income tax.

- The special rules that restrict the amount of capital allowances for cars costing more than £12,000 will be abolished.
- Expenditure on cars with CO₂ emissions of 160gm/km or below will be allocated to the plant and machinery 'pool' (i.e. will obtain 20% writing down allowances).
- Expenditure on cars with CO₂ emissions above 160gm/km will be allocated to the 'special rate pool' (i.e. will obtain 10% WDA).

Expenditure incurred before April 2009 will in general continue to be subject to the existing 'expensive' car rules for a transitional period of around five years. Any expenditure remaining in a single asset pool (unless there is any non-business use of the car) will be transferred to the main capital allowances pool.

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 gm/km (previously 120 gm/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 will be able to reclaim a tax credit from HMRC (not cars).

Short life assets (not cars)

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. Up to 31 March 2008 they were placed in their own pool and qualified for annual allowances at a reduced rate of 6%. They will now be combined with building fixtures in the 10% pool.

Private Use

Where a business asset is used partly for private purposes by the proprietor of the business (i.e. a sole trader or partners in a partnership) the capital allowances are restricted. The asset is not included in any pool but is the subject of a separate calculation. The allowances are computed in the normal way so can in theory now attract the 100% annual investment allowance or the relevant writing down allowance. However, only the business use proportion is allowed for tax purposes. Private use of assets by employees does not require any restriction of the capital allowances.

Buildings

Capital allowances are currently available on certain:

- industrial buildings
- agricultural buildings
- hotels

There are no allowances on:

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

The rate of allowance was 4% of the cost each year up to and including 2007/08.

- Industrial Buildings Allowance (IBAs) and Agricultural Buildings Allowance (ABAs) are now being phased out, with final withdrawal of both regimes by 2011
- most balancing allowances and balancing charges on a disposal of IBAs and ABAs cease to apply for changes in ownership on or after 21 March 2007

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 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 11 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 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
- advising on the timing of asset purchases and sales

- liaising with your advisors (solicitors, surveyors etc) to apportion the cost of property purchases in the acquisition agreement across the appropriate asset categories and thereby maximise the tax allowances available.

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