

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.

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

- Each business irrespective of size will be able to claim a 100% investment allowance for the first £50,000 spent on plant and machinery. This will be available annually, and is known as the 'Annual Investment Allowance' (AIA). There are regulations for commonly controlled businesses to prevent unjust multiple claims.
- Expenditure on all items of plant and machinery continue to be pooled rather than each item being dealt with separately.
- The writing down allowance (WDA) on the general pool is 20% and is 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, known as integral features (eg lighting, air conditioning, heating, etc), 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.
- Additional capital allowances are available for expenditure incurred by a qualifying activity in the 12 month period commencing 1 April 2009 for companies and 6 April 2009 for individuals and partnerships. Expenditure on qualifying plant and machinery not covered by the AIA will be eligible for a temporary first year allowance (FYA) of 40% instead of 20% writing down allowance (WDA). The FYA will not apply for expenditure on integral features, cars, long life assets and assets for leasing.
- 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.

Case study

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.

	£	£
	20%	10%
	pool	pool
	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

Special rules

There are special rules for the treatment of certain distinctive types of expenditure. The first of these is car expenditure. Other vehicles are treated as general pool plant and machinery. This is best summarised as follows:

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

From 1 April 2008

As above except the CO2 emissions now need to be at 110gm/km or less

From 1 April 2008

20% writing down allowance only

From 1 April 2008

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

The following changes take effect for the purchase of cars 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 are abolished.
- Expenditure on cars with CO2 emissions of 160gm/km or below will be allocated to the plant and machinery 'pool' (ie will obtain 20% WDA).
- Expenditure on cars with CO2 emissions above 160gm/km will be allocated to the 'special rate pool' (ie will obtain 10% WDA).
- Cars that have an element of non-business use will continue to be dealt with in a single asset pool to enable the private use adjustment to be made, but for expenditure incurred from April 2009 onwards the rate of WDA will be determined by the car's CO2 emissions.

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 then 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 may be able to reclaim a tax credit from HMRC (not cars).

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. 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 integral features in the 10% pool.

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.

Private use

Where a business asset is used partly for private purposes by the proprietor of the business (ie 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% AIA 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 available on certain:

- industrial buildings
- agricultural buildings
- hotels.

There are no allowances on:

- the cost of land

- showrooms, offices and shops.

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

- Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (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 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.

For information of users: This material is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material can be accepted by the authors or the firm.