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 **abacus** 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. Relief is given on the full cost up to a maximum allowance of £25,000 for a full year. This allowance was significantly reduced from £100,000 with effect from 1 April 2012 for companies and 6 April 2012 for unincorporated businesses.
- 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 18% (previously 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.
- Certain expenditure on buildings fixtures, known as integral features (e.g. lighting, air conditioning, heating, etc) is only eligible for 8% WDA (previously 10%) so is allocated to a separate 'special rate pool'.
- Allowances are calculated for each accounting period of the business.
- There are regulations for commonly controlled businesses to prevent unjust multiple AIA claims.
- There are proposals to introduce a requirement that businesses 'pool' their expenditure on fixtures in a building in order to qualify for allowances. These proposals are expected to be introduced from April 2012.
- From April 2012, a requirement will be introduced for purchasers of property which includes fixtures, that where a past owner was entitled to claim plant allowances on the fixtures (historic expenditure), the purchasers will only be able to claim allowances on the fixtures if the historic expenditure had been allocated to a pool by the past owner and the vendor and purchaser had agreed a value for the fixtures.

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The reduction in the AIA

Where a business has an accounting period that straddles the date of change the allowances have to be apportioned on a time basis.

Case study 1

A company with an accounting period ending on 30 September 2012 will have an allowance of £62,500 (£100,000 x 6/12 + £25,000 x 6/12). However it should be noted that for expenditure incurred after the 1 April 2011 (6 April for an unincorporated business), the maximum allowance that can be attributed to that expenditure is a fraction of £25,000. The fraction will be the amount of the £25,000 that is included in the calculation of the overall AIA for the accounting period.

Case study 1

Suppose a company with the 30 September year end wishes to buy new plant costing £35,000. If they buy it in February 2012 they will be able to claim an AIA on the full £35,000 but if they buy it in June 2012 they will only be able to claim an AIA of £12,500. They would actually then be better off if they waited until October when they would have a full £25,000 available.

Writing down allowances (WDA)

WDA reduced from April 2012. The previous rate of 20% reduced to 18% and the lower rate of 10% which applies to integral features and long-life assets reduced to 8%. It will be necessary to calculate hybrid rates where the accounting period straddles 1 April 2011 (6 April for an unincorporated business) which will give a rate between 20% and 18% (or between 10% and 8%) for that period.

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 for cars

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:

From April 2009

The capital allowance treatment of cars acquired 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
New low emission car not exceeding 110gm/km CO_2	General pool	100% allowance
Not exceeding 160 gm/km CO_2 emissions	General pool	18% WDA (previously 20%)
Exceeding 160 gm/km CO_2 emissions	Special rate pool	8% WDA (previously 10%)

Pre April 2009 acquisitions

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 110gm/km CO2	General pool	100% allowance
Not exceeding £12,000 cost and not low emission	General pool	18% WDA (previously 20%)
Exceeding £12,000 cost and not low emission	Single asset pool for each car	18% WDA (previously 20%) but restricted to £3,000 max. pa

Cars purchased under the old rules and used 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.

Changes ahead - from April 2013

The capital allowance treatment of cars acquired from 1 April 2013 for companies and 6 April 2013 for sole traders is expected to be revised.

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 95gm/km CO2	General pool	100% allowance
Not exceeding 130gm/km CO2 emissions	General pool	18% WDA
Exceeding 130gm/km CO2 emissions	Special rate pool	8% WDA

Non-business use element

Cars and other business assets that are used partly for private purposes, by the proprietor of the business (i.e. 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 gm/km CO_2 emission car which costs £15,000 with 80% business use will attract an allowance of £12,000 (£15,000 x 100% x 80%) when 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 CO_2 emissions up to 110 gm/km.

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

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

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

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. This election is not available for cars or integral features.

For assets acquired from 1 April 2011 (6 April for an unincorporated business) the asset is transferred into the pool if it is not disposed of by the eighth anniversary of the end of the period in which it was acquired. For assets acquired prior to April 2011 the deadline is the fourth anniversary of the end of the period in which is 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 8% 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.

Enterprise Zones

The government has introduced several new Enterprise Zones across the UK.

The government will make a range of policy tools available to all Zones including:

- a 100% business rate discount worth up to £275,000 over a five year period for businesses that move into an Enterprise Zone during the course of this Parliament.
- government and local authority help to develop radically simplified planning approaches in the Zones.

It has been announced that 100% capital allowances will now be available for parts of some of the Zones known as 'designated assisted areas'.

- The relief will only be available to companies.
- The plant must be new and represent an investment not a replacement of existing plant.
- The allowance will apply for purchases made from 1 April 2012 up to 31 March 2017.

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.

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.

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 abacus can help

The rules for capital allowances can be complex. **abacus** 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.

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