Hall Morrice
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KEY GUIDE

Capital allowances

Introduction

Capital expenditure and depreciation cannot be deducted in calculating taxable profits. Instead, many types of capital expenditure qualify for capital allowances, which in effect provide a standard measure of depreciation for assets used in earning income. This guide gives an overview of the tax allowances for capital expenditure and the rules for claiming them.

What allowances are there?

Individuals, partnerships, companies and trusts can claim capital allowances for assets used in a trade, for property letting or in agriculture. The most important allowances are for plant and machinery. Allowances are currently also available for:

- Renovation of qualifying business premises in disadvantaged areas.
- Research and development.
- Patent rights and know-how.
- Mineral extraction, cemeteries and crematoria, and dredging.

Allowances are normally given as a deduction in calculating trading profits or the profits of a property letting business.

Plant and machinery

Allowances are given for plant and machinery that you buy and use wholly or partly in your business. It cannot be equipment that you buy and sell in the normal course of trade. It also cannot be part of the premises or setting in which you carry on the business, such as floor tiles. The distinction between 'plant' and 'setting' can be a fine one, however, and designated integral features of a building do qualify. Examples of these are electrical, water and heating systems, lifts and escalators.

Common items that usually qualify as plant or machinery include computers, office and shop furniture, machinery, tools and motor vehicles.

Businesses can get 100% tax relief in the year of purchase on the first £250,000 of expenditure on most types of plant and machinery by claiming the annual investment allowance (AIA).

- The £250,000 limit is for the two years starting on 1 January 2013. Before that date and from 1 January 2015 it is £25,000 a year.
- Companies that form a group are entitled to only one AIA, which they can divide between them as they wish. The same applies to certain 'related' businesses, such as where an individual or partnership runs more than one business from the same premises.

If your business accounting period spans 1 January 2013, your maximum AIA for the period will depend on the proportions of the period falling before and after that date. For example, a company that draws up accounts from 1 October 2012 to 30 September 2013 will have a maximum AIA of £193,750, calculated as: 3/12 x £25,000 + 9/12 x £250,000. In the year ended 30 September 2014 its maximum

Focus point

If you are planning a programme of capital expenditure of more than £250,000 you may be able to spread it over more than one accounting period to maximise the AIA you can claim.

AIA will be the full £250,000, and in the year ended 30 September 2015 it will be £81,250 (3/12 x £250,000 + 9/12 x £25,000).

If you are planning a programme of capital expenditure of more than your maximum AIA you may be able to spread it over more than one accounting period to maximise the AIA you can claim. For example, if you prepare your company accounts up to 30 September each year and are planning capital expenditure of £250,000 in summer, you could incur £193,750 up to 30 September and £56,250 after that date.

Expenditure over the AIA limit is 'pooled'. The pool also includes cars. A writing-down allowance (WDA) is given each year on the balance of unrelieved expenditure in the pool. When a pooled asset, or an asset on which AIA was claimed, is sold, the proceeds are deducted from the pool balance before calculating the WDA. If the proceeds are greater than the pool balance, the excess – called a balancing charge – is added to the profits. A pool balance of £1,000 or less can be written off in full.

There are two rates of WDA.

- The WDA is 8% for assets in the special rate pool. This pool consists of expenditure on integral features of a building, thermal insulation, long-life assets (those with a useful economic life of 25 years or more), and cars with CO_2 emissions above 130g/km.
- Equipment in the main rate pool qualifies for WDA at 18%.

Focus point

First-year allowances of 100% are available to businesses of any size for qualifying energy-saving or water-efficient equipment, electric vans and low-emission cars. These are new cars with CO_2 emissions of not more than 95g/km.

For example, if you buy machinery costing £250,000 in the accounting period 1 October 2012 to 30 September 2013, you can claim AIA on £193,750 in that period. The remaining £56,250 is carried forward into the next period, when you can claim a WDA of £10,125.

Expenditure on a few assets is not pooled. The main ones are assets partly used outside the business, such as a sole trader's car that is also used for private journeys, and short-life assets.

- Allowances for assets used outside the business are restricted in accordance with the proportion of non-business use. For example, if 25% of a sole trader's car mileage is private, unrelieved expenditure at the beginning of the year is £10,000, and the car has CO_2 emissions above 130g/km, the WDA will be £600. This is calculated as 75% (business proportion) of 8% (WDA special rate) of £10,000.
- Short-life assets are items that depreciate rapidly, such as computers, where you can elect for faster allowances. An asset has a short life if it is not expected to last more than four years after the end of the period in which it was bought.
- A balancing charge or allowance – where sale proceeds are less than the unrelieved expenditure – will generally arise when a non-pooled item is sold.

First-year allowances of 100% are available to businesses of any size for qualifying energy-saving or water-efficient equipment, electric vans and low-emission cars. These are new cars with CO_2 emissions of not more than 95g/km.

Balancing allowances and charges may also arise when a business ends. No WDA or AIA is given in the final period of the business. Any assets that the trader retains after cessation are treated as sold at their open market value.

Flat conversion allowances

A 100% first-year allowance is available for expenditure on converting or renovating unused space, or space used only for storage, above certain types of commercial premises into self-contained flats for residential letting. The allowance is given against letting income.

There are several conditions, the main ones being:

- The construction of the building must have been completed before 1 January 1980.
- The building must not have more than four storeys above the ground floor.
- The flat must not have more than four rooms, excluding any kitchen, bathroom or small hallway, and must not be a high value flat – based on the expected rent for a flat of that size.

The allowance is given as a deduction from letting income. Any unrelieved excess can be set against other income of the same or the following year.

A balancing charge, or occasionally an allowance, is made if certain events, for example a sale or grant of a long lease, occur within seven years of the time when the flat was first suitable for letting as a dwelling.

Business premises renovation allowance

A 100% first-year allowance is available to individuals and companies on the cost of converting or renovating unused business premises in a designated disadvantaged area.

Focus point

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- The building must have been vacant for at least a year.
- After conversion or renovation the building must be used or be available for use for a business.
- The expenditure must be incurred before 11 April 2017.
- If you do not claim the full 100% allowance, for example because you do not have enough income from which to deduct it, a 25% WDA can be claimed each year on the residue of expenditure.

Research and development

Capital expenditure on research and development (R&D) carried out for an existing trade, or a trade that starts later, qualifies for a 100% allowance. A separate R&D tax relief exists for revenue expenditure.

- The cost of any land does not qualify.
- If the trader sells an asset on which relief was given, the sale proceeds (or market value if greater) are added to trading profits.

Other allowances

Capital allowances for patent rights and know-how are given at 25% on the balance of unrelieved expenditure at the beginning of the year.

Mineral extraction allowances are given at 25% on certain expenditure on the acquisition of minerals or rights over them, and pre-trading exploration expenditure.

How we can help

If you are in business or you let property, we can advise you what capital allowances you can claim and how you might be able to maximise the allowances available.

People who buy commercial property often do not appreciate the extent to which they can claim plant and machinery allowances for fixtures and equipment in the building. We can help you identify qualifying costs.

We can also advise you on the tax implications of different methods of acquiring assets, for example purchase or leasing, and on the best timing of your purchase or disposal. You should ask us at an early stage in your plans.

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