

# HM

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KEY GUIDE

# Tax allowances for business investment

# Introduction

## MAKING THE MOST OF YOUR INVESTMENT

Capital expenditure, be it on property, equipment or vehicles, will represent a major investment which you make to set up, maintain or expand your business. It is therefore important that you benefit from any available tax relief.

You cannot deduct capital expenditure or depreciation when calculating your taxable profits. Instead, many types of capital expenditure qualify for capital allowances. But make sure you keep up with any changes to the rules because they are often updated.

For example, a new relief introduced in 2019/20 provides for an annual 2% write-off for the construction costs of commercial property. The annual investment allowance has also been increased temporarily from £200,000 to £1,000,000.

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# The main types of capital allowances

If you use certain assets in a trade, you can claim capital allowances if you are in business as an individual, a partnership, a company or as a trustee of a trust. Allowances may also be available if you let property or are involved in agriculture. The most important allowances are those for plant and machinery, but allowances are also available for:

- Commercial property.
- Research and development expenditure.
- Patent rights and know-how.
- Mineral extraction, cemeteries and crematoria, and dredging.

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

## PLANT AND MACHINERY

You can claim allowances for plant and machinery that you buy and use wholly or partly in your business, but not for items that you buy and sell in the normal course of trade. The asset cannot be part of your premises or the setting in which you carry on the business, such as floor tiles.

The distinction between 'plant' and 'setting' can be a fine one, although certain integral features of a building qualify for allowances regardless of the distinction – for example, 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 vehicles.

Your business can qualify for 100% tax relief in the year of purchase on the first £1,000,000 of expenditure on most types of plant and machinery by claiming the annual investment allowance (AIA).

- The £1,000,000 limit is temporary, applying for the period 1 January 2019 to 31 December 2020. Previously the limit was £200,000 a year, and it will revert to this level from 1 January 2021. If your accounting period spans 1 January 2019, your maximum AIA for the period will depend on the proportions of the period falling before and after that date.
- The AIA is not available for expenditure on cars. Cars are defined as vehicles suitable for private use (including motor homes) and not built for transporting goods. Therefore, the AIA is available for expenditure on lorries, vans and trucks – and also motorcycles.
- Companies that are part of a group are entitled to only one AIA between them, but it can be divided as they wish. The same restriction applies if you have two related businesses that are run from the same premises.

### Planning point

The increase in the AIA is only temporary, so if you are planning an extensive programme of capital expenditure it will probably make sense to incur as much of this as possible prior to 31 December 2020.

**EXAMPLE****Working out the AIA**

Birch Ltd has drawn up accounts for the year ended 30 June 2019. For this period, the company will have a maximum AIA of £600,000, calculated as  $6/12 \times £200,000$  (for the period 1 July to 31 December 2018) +  $6/12 \times £1,000,000$  (for the period 1 January to 30 June 2019). However, the maximum AIA that can be claimed in respect of expenditure during the period 1 July to 31 December 2018 is £200,000, despite the overall maximum of £600,000. In the year ended 30 June 2020, Birch Ltd's maximum AIA will be the full £1,000,000

**Second-hand buildings**

Establishing the amount of expenditure that qualifies as plant and machinery can be difficult if you purchase a building, especially if the building is purchased second-hand. With a second-hand building, it is generally necessary for you and the seller to make a joint election regarding the value to be placed on the integral features. Also, no allowances will be available unless the seller has pooled the expenditure (see below for an explanation of pooling), even where the seller has never claimed any capital allowances.

**First-year allowances**

A separate first-year allowance of 100% is available for expenditure on:

- New electric cars and low-emission cars – a low-emission car is one with CO<sub>2</sub> emissions of up to 50g/km (75g/km prior to 1 April 2018).
- Charge-point equipment for electric vehicles.

- Zero-emission goods vehicles, such as electric vans.
- Qualifying energy-saving equipment, such as high-efficiency lighting units and solar thermal systems (this allowance will end in April 2020).
- Qualifying water-efficient equipment that is designed to improve water quality and/or reduce water use, for example, water-efficient showers and taps, and vehicle-wash water reclaim units (this allowance will end in April 2020).

A 100% first-year allowance is also available for the cost of investing in plant and machinery within certain designated enterprise zones – those where there is a strong focus on manufacturing.

**RESEARCH AND DEVELOPMENT EXPENDITURE**

If you incur capital expenditure on research and development (R&D) related to a trade you are carrying on (or for a trade you are about to carry on), the expenditure can qualify for a 100% allowance. It should be noted that:

- The cost of any land does not qualify.
- If you subsequently sell an asset on which relief has been given, the sale proceeds will be added to your trading profits.

There is a separate R&D tax relief for revenue expenditure.

**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.



## POOLED EXPENDITURE

Any expenditure over your AIA limit, including on cars, is 'pooled' into one of two pools. A writing-down allowance (WDA) is given every year on the balance of unrelieved expenditure in each pool. Which pool expenditure goes into depends on the type of asset.

When you sell a pooled asset, or an asset on which you have claimed AIA, the proceeds are deducted from the relevant pool balance before calculating the WDA. If the proceeds are greater than the pool balance, the excess - called a balancing charge - will be added to your profits.

A pool balance of £1,000 or less can be written off in full.

There are two rates of WDA:

- Assets in the main pool qualify for WDA at 18%. Cars with CO<sub>2</sub> emissions between 51g/km and 110g/km (between 76g/km and 130g/km prior to 1 April 2018) are included in this pool.
- 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<sub>2</sub> emissions above 110g/km (130g/km prior to 1 April 2018). This rate will be reduced to 6% from 6 April 2019 (1 April 2019 for companies).

### EXAMPLE Pooling

Oak Ltd buys machinery costing £1,270,000 during the year ending 31 December 2019. It can claim AIA on £1,000,000 of the expenditure and the other £270,000 will be added into the main pool. The WDA is £48,600 (£270,000 at 18%), with the remaining balance of £221,400 being carried forward to the year ended 31 December 2020, where a further WDA of 18% can be claimed on this brought forward figure.

As far as the main and special rate pools are concerned, a balancing allowance can only arise in the year that the business ceases. In the final year of trading, sale proceeds are deducted from the pool balance (no WDA or AIA is given). If sale proceeds are less than the balance then there will be a balancing allowance, and if the proceeds are greater there will be a balancing charge.

### Planning point

The lists of qualifying energy-saving and water-efficient technologies are updated annually to reflect technological advances and changes in standards. Therefore, make sure that your information is up to date when planning for such expenditure.

## EXPENDITURE THAT IS NOT POOLED

Some expenditure is not pooled. This is mainly expenditure on short-life assets and on assets which you use partly for private purposes. This will include your car if you are in business as a sole trader or partner - but it does not include cars available for the private use of employees, because such cars are pooled.

Short-life assets are those items that depreciate rapidly, such as computers, where you can make an election allowing you to claim faster allowances. An asset has a short life if it is not expected to last more than eight years after the end of the period in which it is bought.

Electing for short-life assets treatment is only worthwhile if the expenditure does not qualify for AIA, i.e. because you have already exhausted your AIA limit for the current period.



### EXAMPLE

#### Short-life asset

Beech Ltd bought computer equipment costing £40,000 on 15 April 2018. The computer equipment has a life of 18 months, after which it will be scrapped. Beech Ltd had already exhausted its AIA limit for the year ended 31 March 2019.

If no short-life asset election is made, the computer equipment will be added into the main pool with WDAs at the rate of 18% given each year.

If an election is made, the computer equipment will not be pooled. The WDA for the year ended 31 March 2019 will be the same (£40,000 at 18% = £7,200), but a balancing allowance of £32,800 (£40,000 - £7,200) will then be given in the year ended 31 March 2020 when the computer equipment is scrapped. The cost is therefore effectively written off over the 18-month life of the asset.

Allowances for assets that you use partly for private purposes are restricted in accordance with the proportion of non-business use.

### EXAMPLE

#### Private use of an asset

Clare is in business as a sole trader. Her car (CO<sub>2</sub> emissions are 80g/km) cost £15,000, with 25% of the mileage being for private purposes. The WDA is restricted to 75% of the normal rate, so in the year of purchase Clare is entitled to a WDA of £2,025 (£15,000 at 18% x 75%).

A balancing charge or allowance (where sale proceeds are less than the unrelieved expenditure) will arise when a non-pooled item is sold.

#### Planning point

If you personally retain assets after cessation, they will be treated as sold at their open market value – increasing the amount of tax that you will have to pay for the final year of trading. Without any compensating sale proceeds, you will need to plan for this tax cost.

### LONG AND SHORT ACCOUNTING PERIODS

If your accounting period is less than 12 months, the amount of AIA and rate of WDA are reduced accordingly. So, for an eight-month period the AIA is £666,667 (£1,000,000 x 8/12) and the rates of WDA are restricted by 8/12.



For individuals and partnerships, the same principle normally applies to periods longer than 12 months. For a 15-month accounting period the AIA would be £1,250,000 (£1,000,000 x 15/12) and the rates of WDA are increased by 15/12.

However, a company cannot have an accounting period of longer than 12 months – such a period must be split into two. So, for a 15-month period, there will be a 12-month period with the normal AIA and rates of WDA, and a three-month period with reduced allowances. This treatment also applies if a sole trader or partnership has an accounting period longer than 18 months.

First-year allowances are always given in full, regardless of the length of the accounting period.

### CASH BASIS

Capital allowances are generally not relevant if you use the cash basis (available to individuals with an annual income up to £150,000) to calculate your trading profit. Expenditure on business assets such as machinery, computers and vans is simply deducted as an expense, although capital allowances may still be relevant when it comes to cars.

#### Planning point

Make sure that you are claiming for the cost of replacement furniture and furnishing. A property does not need to be fully furnished for relief to be available.



## STRUCTURES AND BUILDINGS

A new relief known as the structures and buildings allowance (SBA) is being introduced if you buy commercial property where the construction contract was signed on or after 29 October 2018, with relief given at an annual flat rate of 2% over a 50-year period. A separate SBA will be given for each structure or building qualifying for relief.

- Offices, retail and wholesale premises, walls, bridges, tunnels, factories and warehouses can all qualify for relief.
- The value of land is excluded, as is any part of a building used as a dwelling house. Work spaces within domestic settings, such as home-offices, also do not qualify for relief. Expenditure that qualifies as plant and machinery cannot also qualify for the SBA.
- If you buy an unused building that has been constructed by a developer, then the qualifying expenditure will be the price that you pay less the value of the land.
- The property must be used for a qualifying activity such as a trade or property letting. Allowances can be claimed once the property is brought into qualifying use.
- It doesn't matter if the property is situated overseas as long as your business is within the charge to UK tax.
- Unlike plant and machinery, there will be no balancing charge or balancing allowance when you sell the property. Instead, the purchaser will simply continue to claim the 2% allowance for the remainder of the 50 years based on your original cost.
- Relief is also available for the cost of converting or renovating a property. The expenditure will qualify for its own separate 2% write-off over the next 50 years.
- Where a structure or building is demolished without being replaced the SBA can continue to be claimed for the remainder of the 50-year term.

### EXAMPLE

#### Structures and buildings allowance

Elm Ltd bought an office building from a developer on 1 April 2019 for £800,000, with £350,000 of this being the value of the land. The building was immediately brought into use for Elm Ltd's trade. From the year ended 31 March 2020 onwards, Elm Ltd can claim an SBA of £9,000 ((£800,000 - £350,000) at 2%). The claim will continue for the next 49 years unless the office building is sold before then.

### LET PROPERTY

Capital allowances are not available for assets such as tables, beds, carpets, cookers and washing machines used in a dwelling. The exception is if your property qualifies as a furnished holiday letting, since the short-term nature of holiday lets makes this more akin to running a business.

However, replacement furniture relief allows you to claim a 100% deduction for the cost of replacing furniture, furnishings, appliances and kitchenware provided for a tenant's use. No relief is given for the initial cost of furnishing a property or for any part of the cost representing an improvement. The amount of relief is reduced by any proceeds from selling the old asset which has been replaced.

### EXAMPLE

#### Replacement furniture relief

Joe purchased a house on 6 April 2018 and let it out throughout 2018/19. During April 2018, he furnished the house with a cooker costing £460, a washing machine costing £370 and floor coverings costing £2,400.

The cooker was sold during January 2019 for £90, and replaced with a similar model costing £500. The washing machine was scrapped, with nil proceeds, during March 2019. It was replaced by a washer-dryer costing £660, although the cost of a similar washing machine would have been £380.

No relief is available for the initial cost of the cooker, washing machine and floor coverings. Relief for the replacement cooker is £410 (£500 - £90). Relief for the washer-dryer is restricted to £380, since no relief is given for that part of the cost that represents an improvement over the original washing machine.

### PARTNERSHIPS

Capital allowances must be claimed by the partnership collectively in the partnership tax return, not by the partners in their individual returns. Partners may often own business assets individually, especially cars, but capital allowances must be claimed in the partnership return. This means that a

partner with an expensive car effectively shares some of their allowance with other partners who may have less expensive cars.

### THE VALUE TO USE

With an outright purchase, you can claim capital allowances based on how much the item cost you, including any costs directly related to the acquisition. However, you cannot claim for interest or finance costs as these will be deducted as a normal business expense. The same principle applies if you buy an asset on hire purchase or by an alternative finance method – you can only claim capital allowances on the cost of the item itself, not the interest or other charges.

If you are VAT registered, you claim capital allowances on the net of VAT cost of the asset. However, if you are not VAT registered you will claim capital allowances on the total price paid, including the VAT element. The same principle applies if you are VAT registered but cannot reclaim all of the VAT – any irrecoverable VAT is included in the figure on which you can claim capital allowances. VAT is irrecoverable where cars are not used 100% for business purposes, and also where you make exempt supplies.

#### EXAMPLE VAT and business use

Martha, who is registered for VAT, purchased a car on hire purchase. The cost of the car was £15,000, including VAT of £2,500, and the total price to be paid under the hire purchase agreement is £17,600. Unless the car is used 100% for business use, capital allowances will be based on the VAT inclusive cost of £15,000.

#### Planning point

Don't forget, when you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business.

If you receive a business asset by way of a gift, then you can claim capital allowances based on the asset's market value when you start using the asset in your business.

When an asset is sold, the proceeds figure to be brought in is restricted to the original cost should you sell an asset for more than you paid for it. Proceeds will be net of VAT if you are VAT registered.

### WHEN IS EXPENDITURE INCURRED?

Expenditure is normally treated as incurred on the date when your obligation to pay becomes unconditional. However, there is an exception to this general rule. If you do not have to pay within four months, expenditure is not treated as incurred until the payment date.

When you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business. The expenditure is treated as incurred on the date you start to trade, and assets will be brought in at their market value on that date.

### Restricting capital allowance claims

A very useful feature of capital allowances is that claims can be restricted to meet your personal circumstances.

#### EXAMPLE Restricting a claim to capital allowances

If your trading profit before capital allowances for 2018/19 will be £15,000, and the maximum capital allowances claim is £9,000, then you might claim just £3,150. The resulting profit of £11,850 would then exactly be covered by your personal allowance of £11,850. Or you might decide to claim a higher amount of capital allowances, since self-employed national insurance contributions are payable where profits exceed £8,424 and tax credits start to be withdrawn once income exceeds £6,420.



### HOW WE CAN HELP

If you are in business or you let property, we can advise you about 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, and you may be entitled to the new SBA.

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



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