Capital Allowances

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Overview

Most day to day business expenses can be deducted from business income when calculating your taxable profits. However the rules are different for 'capital' expenditure. 'Capital allowances' is the term used to describe the allowances which allow businesses to secure tax relief for certain capital expenditure. Most 'capital' items, such as computer equipment, vehicles, machinery etc last for more than a year or so. The tax rules do not allow you to automatically deduct the full cost of such items in one go. And different rules apply to different types of capital expenditure. In some cases no tax relief is available at all even though you may have spent the money solely for business purposes.

This guide provides an overview of the main types of capital allowances that can be claimed and is aimed at businesses with relatively straight forward tax affairs.

Capital allowances are available in respect of:

— Most 'plant and machinery' used for business purposes;
— Certain building works - for example converting space above commercial premises to flats for renting;
— Certain research and development expenditure.

Your entitlement to claim capital allowances is usually unaffected by how you pay for the items in question. For example, if you buy an item on hire purchase you can claim capital allowances based on the full normal cost of the item. The interest you pay and other charges are not part of the capital cost of the item but can usually be counted as deductible business expenses.

If you simply rent capital equipment, and do not secure ownership of the items, no capital allowances can be claimed. Instead the payments due, under what is usually called an 'operating lease', are simply deductible as a normal business expense.

Plant & Machinery

The official term 'Plant and Machinery' (P&M) includes items such as cars, vans, machines, equipment, computers, furniture and other similar items used by a business.

Some of the rules related to P&M depend on the nature of the expenditure and how much money has been spent on P&M during the accounting period. There are also special rules to provide tax relief for items of P&M you used privately before using them in your business and items that you only partly use for business purposes.

Annual Investment Allowance (AIA)

The AIA is available to all businesses regardless of size. This AIA allows businesses to write off 100% of the cost of qualifying P&M, up to the allowed maximum, against taxable profits.

Most businesses had an AIA of £50,000 for P&M purchased during the 2008-09 and 2009-10 tax years. This limit was increased to £100,000 during the 2010-11 tax year and subsequently reduced in April 2012 to £25,000. The AIA increased from £25,000 to £250,000 for a two year period with effect from 1 January 2013.

This limit doubled to £500,000 from 6 April 2014 (for unincorporated businesses and 1 April 2014 for companies) until 31 December 2015. From 1 January 2016, the limit has been permanently set at £200,000.

There are transitional rules for businesses whose accounting periods span the operative date of the changes.

Writing Down Allowances

For plant and machinery expenditure that exceeds the AIA and which does not qualify for a First-Year Allowance (see below), a standard 18% Writing Down Allowance (WDA) is available. This is based on the cost of the items in the year they are acquired. The Writing Down Allowance was reduced to 18% from April 2012.

First-Year Allowances

Where AIA is not available, businesses can claim First-Year Allowances (FYA) of 100% in the year they purchase certain plant or machinery. As with the AIA this allows businesses to deduct the whole purchase cost of qualifying assets from their taxable profits.

Examples of plant and machinery that typically qualify for the 100% FYA include:

— Energy-saving plant and machinery.
— Environmentally beneficial plant and machinery.

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Director
Alan Palfrey
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Special cases

Most plant and machinery is treated in a standard way for capital allowances, however there are special rules for expenditure on:

- Cars.
- Long-life assets.
- Short-life assets.
- Integral features of buildings and thermal insulation.
- Assets bought by businesses and then leased out.

Cars

Qualifying expenditure on cars must be allocated to one of two general P&M pools of expenditure. Which pool is appropriate depends on the car's CO_2 emissions. Expenditure on cars with CO_2 emissions over 130g/km driven will be dealt with in the special rate pool and will attract a WDA of 8% p.a.

Expenditure on cars with CO_2 emissions of up to and including 130g/km driven will be dealt with in the main pool and will attract a WDA of 18% p.a. Cars that have an element of non-business use, by the self-employed, must be allocated to a single asset pool to enable the private use adjustment to be made. Cars with CO_2 emissions up to 75g/km benefit from 100% capital allowances.

Cars purchased before 1 April 2009 (Corporation Tax) and 6 April 2009 (Income Tax) continue to be treated under the old rules for a transitional period of five years. This means that cars with no non-business use costing:

- Less than £12,000 continue to be handled in the main rate pool regardless of their emissions. The tax relief for such cars is set at 18% of the tax written down value each year.
- £12,000 or more continue to be treated individually. The tax relief for such cars is set at 18% of the tax written down value each year, subject to a maximum of £3,000 allowance per year.

Short-life assets

There are special rules when a business purchases equipment that it expects to keep for a short time or that is expected to wear out quickly.

If the life of the asset is 'short', businesses can choose to calculate the capital allowances outside the main pool. This will generally mean more tax relief but only when the assets are written off, scrapped or sold.

Long-life assets

This term refers to assets with an expected useful life of more than 25 years. The tax allowance here is set at 8% of the written down value each year with all expenditure on long life assets being added to a special 8% rate pool.

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Integral features of buildings and thermal insulation

The same relief as for other long life assets is also available for the cost of new or replacement 'integral features' of a building.

Such features are:

— Cold water systems.
— External solar shading.
— Lifts, escalators, and moving walkways.
— Active facades electrical systems (including lighting systems).
— Space or water-heating systems, powered systems of ventilation, air cooling or air purification, and any floor or ceiling comprised in such systems.

Businesses can also claim the 8% allowance each year for expenditure on installing thermal insulation in all existing buildings used for any qualifying business purpose - other than if it's a residential property business.

Research and Development

R&D tax credits were introduced for Small and Medium Sized Enterprises (SMEs) in 2000 and for large companies in 2002. R&D credits are a CT relief which were introduced to encourage innovation and enterprise within the UK economy. SMEs can currently claim R&D tax credits of 230% for expenditure incurred on or after 1 April 2012.

Since April 2016, large companies can only claim an 11% tax credit for qualifying expenditure. The tax credits large company scheme was withdrawn with effect from 31 March 2016. Universities and charities are no longer able to claim the R&D tax credits for expenditure after 1 August 2015.

The rules as to what qualifies in this regard are complex. In general however, a project qualifies as R&D if:

— It seeks to achieve an advance in science or technology.
— The research is relevant to the business.
— The business is of a trading nature as distinct from someone working in a profession or vocation.

Assets leased out

In certain circumstances businesses can claim capital allowances for assets they own and lease to other businesses.

Private use

This section is only relevant if you operate your business as a sole trader or partnership and is therefore not relevant if your business is a limited company.

Where a business asset is used partly for private purposes the entitlement to capital allowances are restricted. The asset is not included in any pool but is the subject of a separate calculation.

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The allowances are computed in the normal way so can in theory 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.

Claiming capital allowances

All claims for capital allowances are made through the business's annual tax returns.

You do not need to claim the full amount of the available allowance. You might choose to limit your claims to capital allowances to avoid other allowances or reliefs being wasted.

How we can help

We would welcome the opportunity to assist you in maximising your claims to capital allowances. We can also help you arrange your business expenditure generally so as to maximise your entitlement to secure tax relief.

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