

Capital Allowances

Overview

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 are purchasing. Here is an overview of the types of expenditure which qualify for capital allowances and the amounts available.

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

The Annual Investment Allowance (AIA) provides a 100% deduction for the cost of most plant and machinery (not cars) purchased by a business up to an annual limit and is available to most businesses. Where businesses spend more than the annual limit, any additional qualifying expenditure generally attracts an annual writing down allowance (WDA) of only 18% (or 6% for the special rate

pool) depending on the type of asset. Before April 2019 the special rate pool writing down allowance was 8%. For chargeable periods spanning April 2019, the rate of WDA will be a hybrid of the rates before and after the change.

The maximum amount of the AIA depends on the date of the accounting period and the date of expenditure. The AIA from 1 January 2019 is £1 million for two years. It will revert to £200,000 from 1 January 2021. Complex rules apply to accounting periods straddling 1 January 2021.

Where purchases exceed the AIA, a WDA is due on any excess in the same period. Cars are not eligible for the AIA, so will only benefit from the WDA (see special rules for cars).

Please contact us before capital expenditure is incurred for your business in a current accounting period, so that we can help you to maximise the AIA available.

Pooling of expenditure and allowances due

- 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 main rate pool.
- A writing down allowance (WDA) on the main rate pool of 18% 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 (eg lighting, air conditioning, heating, etc) is only eligible for a 6% WDA (8% before April 2019) so is allocated to a separate 'special rate pool', though integral features do qualify for the AIA.
- Allowances are calculated for each accounting period of the business.
- 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.

Structures & Buildings Allowance

Expenditure incurred on business-related buildings and structures on or after 29 October 2018 will attract an annual writing down allowance on a straight-line basis.

The rate was 2% but this has been increased to 3% from 1 April 2020 for the purposes of corporation tax and 6 April 2020 for the purposes of income tax. This allowance is designed to encourage investment in the construction of new structures and buildings that are intended for commercial use, the necessary works to bring them into existence and the improvement of existing structures and buildings, including the cost of converting existing premises for use in a qualifying activity. Neither land nor dwellings are eligible for relief. Where there is mixed use, for example, between commercial and residential units in a development, the relief is reduced by apportionment. No relief is available for work spaces within domestic settings, such as home offices.

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:

Acquisitions from April 2018

The following rules apply:

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 50g/km CO ₂	Main rate pool	100% allowance
Not exceeding 110g/km CO ₂ emissions	Main rate pool	18% WDA
Exceeding 110g/km CO ₂ emissions	Special rate pool	6% WDA - 8% for periods before April 2019

First year allowances for business cars from April 2021

There will be an extension to 100% first year allowances for zero-emission cars. CO₂ emission thresholds will also be amended from April 2021. These determine the rate of capital allowances available through which the capital expenditure for business cars can be written down. The thresholds will be reduced from 50g/km to 0g/km for the purpose of the first year allowances for low CO₂ emission cars and from 110g/km to 50g/km for the purpose of WDAs for business cars.

Non-business use element

Cars and other business assets that are used partly for private purposes, by the proprietor of the business (ie 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 the purchase of a new zero 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 new cars with CO₂ emissions up to 50g/km.

A 100% first year allowance (FYA) is currently available to all businesses for expenditure on the purchase of new environmentally friendly equipment.

- www.gov.uk/guidance/energy-technology-list 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.
- 100% FYA is available on electric car charging points until 2023.

A 100% FYA and first year tax credits for products on the Energy Technology List and Water Technology List ceased from April 2020.

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.

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.

Long life assets

These are assets with an expected useful life in excess of 25 years. These assets are combined with integral features in the special rate 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.

Other assets

Capital expenditure on certain other assets qualifies for relief. Please contact us for specific advice on areas such as qualifying expenditure in respect of enterprise zones and research and development.

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. Please do contact us if you would like further advice.