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Capital allowances

What is a capital allowance?

If you buy an asset to use in your business that has a life of more than two years, you may not be able to deduct the whole cost from that year's profits. Instead you may get tax relief over several years as capital allowances.

There are several types of capital allowance.

Since 2008, there has been an annual investment allowance (AIA). The amount reduces from £100,000 a year to £25,000 from 1 April 2012 for companies, and from 6 April 2012 for individuals and partnerships.

If all your assets come within this allowance, you may (with a few exceptions) deduct the whole cost from the taxable profits of the year in which you acquired the asset.

There are a few environmentally-friendly assets where you may be able to claim a 100 per cent first year allowance. This means that, again, you may deduct the whole cost from taxable profits.

Having considered these allowances, there is usually a writing down allowance where each year you can claim a portion of what is left.

Example: You buy an asset for £300,000 that qualifies for £100,000 annual investment allowance and a writing down allowance at 20 per cent a year.

Cost:		**£300,000**
Year 1	Annual investment allowance	(£100,000)
	20 per cent writing down allowance on £200,000	(£40,000)
	Written down value	£160,000
Year 2	20 per cent writing down allowance on £160,000	(£32,000)
	Written down value	£128,000
Year 3	20 per cent writing down allowance on £128,000	(£25,600)
	Written down value	£102, 400

and so on.

For what items may capital allowances be claimed?

In practice, most capital allowances are concerned with plant and machinery. However capital allowances can also be claimed for these items.

- renovation of business premises
- research and development
- mineral extraction
- patents and know-how
- dredging
- cemeteries and crematoria.

The government has also announced that there will be some special capital allowances for enterprise zones in assisted areas.

For capital expenditure, an allowance can only be claimed if it comes within one of these categories.

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Capital allowances

So what is plant and machinery?

Machinery is any device with moving parts. It does not have to have to be connected to any form of power, so, for example, a locking mechanism is machinery.

Plant is equipment *with which* you conduct your business. This definition comes from a case of 1887 which held that a wharfinger's horse was "plant".

There have been hundreds of cases on exactly what constitutes plant with which a business is carried out as against premises *in which* a trade is conducted. The answers are not always obvious. For example a dry dock was held to be plant. Similarly, in 2011, it was held that a gazebo in a pub garden for smokers was plant. Statutory guidance is given in an Act of 2001 on a range of items from advertising hoardings to zoo cages.

Calculating entitlement to capital allowances

For the writing down allowance, plant and machinery is either included in a 'pool' or has its allowances calculated separately.

There are two types of pool: the main pool and a special rate pool. The rates until 1/6 April 2012 are 20 per cent and 10 per cent respectively. From 1/6 April 2012, the rates are 18 per cent and 8 per cent.

An asset is not put in a pool if it is either a long-life asset or a short-life asset.

Long-life assets are those with an expected life of 25 years or more. Long-life assets *must* be included in the special rate pool.

Short-life assets are those with an expected life of up to eight years (four years before 1/6 April 2011), although these *may* be kept in the pool if you wish. The advantage of making a short-life asset election is that if you dispose of an asset which still has a written down value, you may also be able to claim a balancing allowance.

A pool that is written down each year never reaches zero. To avoid small figures, the law now allows a pool to be wholly written off if its value falls below £1,000.

Bringing expenditure forward

It may be possible to save tax by bringing forward spending on assets, particularly now that rates of corporation tax are reducing: £100,000 of capital allowance is worth £26,000 when the main rate of corporation tax is 26 per cent, but only £23,000 at 23 per cent.

You do not have to take the whole capital allowance. It is possible to take a lower amount in one year so more can be claimed in later years.

If you borrow money to pay for an asset, the loan relationship tax rules may need to be considered.

What about buildings?

You can no longer claim for industrial or agricultural buildings themselves. But from 1 April 2008, it is possible to claim plant capital allowance for features integral to a building (FITAB). This includes such items as electrical systems, lifts and air conditioning.

When a property is sold, the purchaser and seller should agree the figure attributable to FITAB.

What about cars?

Cars are plant and machinery but have some special rules.

If a car has exhaust emissions below 110 g/km, and is new and unused, it qualifies for a 100 per cent first year allowance and so you may deduct the whole cost from taxable profits.

For higher emissions, the car attracts the higher rate of capital allowance for emissions up to 160 g/km, and at the lower rate for emissions above this figure.

If a car has higher emissions and is bought for leasing, a capital allowance may only be claimed for 85 per cent of its cost.

It should also be noted that if the car is to be used as a company car, the employee could be liable to pay tax on the benefit. The amount is also influenced by the car emissions.

We can advise you on how to minimise both tax liabilities if considering buying a car.

Tax planning using capital allowances

There are many ways in which capital allowances may be used to reduce your tax liability.

How capital allowances may reduce your tax liability

- Bring forward expenditure to maximise relief before tax rates reduce
- Allocate the annual investment allowance to assets with a lower rate of writing down allowance
- Don't claim the full allowance when this could restrict loss relief
- Consider using environmentally-friendly assets and low emission cars
- Make an election for short-life assets not to be put in a pool
- Claim as much as possible as plant rather than premises
- Agree a figure for features integral to a building when buying premises.

Please ask for our advice

You should not buy something just to claim the capital allowance. You show only buy something because you can commercially justify buying it. However considering capital expenditure and the entitlement to claim capital allowances can save you tax.

While this update is somewhat technical in its content it is intended to provide an update regarding important areas of tax and business planning. By its nature, this update provides a generic overview so do please ask for us for personal advice specific to your circumstances.

Please note that the rules relating to capital allowances may change in the 21 March 2012 Budget announcements.