



CORPORATE AND BUSINESS TAX

Capital Allowances

The cost of purchasing capital equipment in a business is not a 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're claiming for. In this factsheet we give you an overview of the types of expenditure for which capital allowances are available and the amount of the allowances.

Capital allowances are not generally affected by the way in which the business pays for the purchase. However any interest on an overdraft or loan taken out to fund the purchase is treated as a normal (tax deductible) business expense. It is not part of the cost of the asset. If you lease equipment then the rent is a business expense not a capital allowance. Where an asset is acquired on hire purchase, allowances are given as though there were an outright purchase. Subsequent instalments of capital are ignored and the interest element is treated as a normal (tax deductible) business expense.

This factsheet sets out the current rules for capital allowances. The government has announced proposals to make significant changes to the system from 2008/09. These changes are set out in 'Proposed Changes' towards the end of this factsheet.

Plant and Machinery

This includes items such as machines, equipment, furniture, computers, cars, vans and similar equipment you use in your business.

Note that there are special rules for cars and certain 'environmentally friendly' equipment and these are dealt with below.

In simple terms the standard allowance is 25% per annum. However:

- Small and medium-sized businesses (as defined for company law) can claim 40% of the expenditure in the year of purchase (this is referred to as a first year allowance (FYA)). For a period of two years commencing on 6 April 2006 (1 April 2006 for companies) small businesses are able to claim FYAs at 50%.
- Expenditure on all items of plant and machinery is generally 'pooled' rather than each item being dealt with separately.
- The 25% allowance which is referred to as a writing down allowance (WDA) is calculated as 25% of the balance remaining in the pool at the end of the previous period.
- When an asset is sold, the sale proceeds (or original cost if lower) are brought into the 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.

- Allowances are calculated for each accounting period of the business.

Case study

During the year to 31 December 2006, a medium-sized business buys plant and machinery costing £80,000.

A FYA of 40% is due and this amounts to £32,000. The balance to carry forward to the next period is £48,000 (being £80,000 less the FYA of £32,000).

In the year to 31 December 2007, plant is sold for £10,000 (original cost £14,000) and new machinery is purchased for £16,000. The allowances due are calculated as follows:

	£	£
Pool brought forward	48,000	
Less: Disposal	(10,000)	
	38,000	
WDA @ 25%	(9,500)	9,500
	28,500	
New machinery	16,000	
FYA @ 40%	(6,400)	6,400
	9,600	
Pool carried forward	£38,100	
Total allowances		£15,900

Exclusions From The Pool

There are special rules for the following.

Cars costing more than £12,000

Each car is dealt with separately and not included in the pool unless it has CO₂ emissions not exceeding 120 gm/km in which case yet another set of rules applies (see below).

No FYA is given and the maximum WDA is £3,000. A WDA is available in the year of purchase.

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Cars costing less than £12,000

These can be pooled with other plant and equipment but they still do not qualify for FYAs. Instead a WDA is given in the year of purchase.

Environmentally friendly equipment

This includes items such as energy saving boilers, refrigeration equipment, lighting and water meters as well as cars with CO₂ emissions up to 120 gm/km.

A FYA of 100% is available to all businesses for expenditure on the purchase of new (and not second hand) environmentally friendly equipment.

www.eca.gov.uk gives further details of the qualifying categories.

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.

The asset is transferred into the pool if it is not disposed of by the fourth 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. They are pooled separately and qualify for annual allowances at a reduced rate of 6%.

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.

Private use

Where a business asset is used partly for private purposes by the proprietor of the business (ie a sole trader or partners in a partnership) the capital allowances are restricted. The asset is not included in the pool but is the subject of a separate calculation. The allowances are computed in the normal way (40%, 25% etc) but 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.

Buildings

Capital allowances are available on certain:

- industrial buildings
- agricultural buildings
- hotels.

There are no allowances on:

- the cost of land
- showrooms, offices and shops.

The rate of allowance is 4% of the cost each year.

Enterprise Zone buildings

Commercial buildings in designated Enterprise Zones qualify for a 100% initial allowance. However there are only a few still in

existence. Instead 100% capital allowances will become available for expenditure incurred on the conversion or renovation of qualifying business premises in disadvantaged areas. The start date for this new scheme has yet to be announced.

Flats

A 100% allowance is available for the costs of converting redundant space over shops and offices into flats for short-term letting. The rules are complex and care must be taken to ensure that all of the necessary conditions are complied with.

Other Assets

Capital expenditure on certain other assets qualifies for capital allowances. For example:

- **patents**, specifically the expenditure on devising and patenting an invention, qualifies for a 25% annual allowance calculated on a reducing balance basis. For companies, the treatment of patents has changed from 1 April 2002. Capital allowances will not normally apply in respect of patent rights acquired on or after that date.
- **research and development (R&D)** qualifies for a 100% allowance. In some circumstances the relief can be claimed as R&D tax credit.

Proposed Changes

The system of capital allowances is to be significantly revised from 2008/09. The proposals are:

- Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) will be phased out, with final withdrawal of both regimes by 2011
- most balancing allowances and balancing charges for IBAs and ABAs cease to apply for changes in ownership on or after 21 March 2007
- writing down allowances for plant and machinery will be cut from 25% to 20%
- writing down allowances for certain fixtures in a building will be cut from 25% to 10%
- writing down allowances for long life assets will be increased from 6% to 10%.

In addition the following changes will be subject to consultation:

- a new investment allowance for the first £50,000 spent on plant and machinery
- where businesses have a loss after claiming 100% capital allowances on green technologies they will be able to reclaim a tax credit from HMRC.

The capital allowances that can be claimed on business cars have not altered but proposed changes to the rules are being consulted on further.

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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.

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