

haleys

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Capital allowances

This guide looks at claiming capital allowances to minimise your business' tax bill

A capital allowance is the tax equivalent of depreciation.

For example, a business buys a lathe for £10,000 and believes the lathe has an estimated useful working life of 10 years. The business may choose to depreciate the asset at the rate of £1,000 a year until it has a net book value of zero after 10 years.

Depreciation is generally not allowed for tax purposes and therefore any depreciation in the accounts must be added back to increase taxable profits. Instead, you may be able to claim a capital allowance.

Claiming capital allowances

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

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

There are no capital allowances for land and buildings, although certain fixed plant and machinery within a building may be eligible.

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

Defining plant and machinery

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

Plant is equipment which a person uses to conduct their business. It does not include the premises in which a person conducts their business. This has led to some fine distinctions.

Plant must have an expected life of at least 2 years and be required for the functions of the business. Some small items, such as replacement loose tools, may be regarded as revenue expenditure. This means that you are able to claim tax relief immediately and not over many years.

The exact scope of what comprises plant can at times be very marginal yet have a big impact on the tax you pay. If expenditure qualifies for a capital allowance you will receive tax relief on the whole amount, albeit over many years. If an item does not qualify for a capital allowance it can mean that you do not receive tax relief for it at all.

Talk to us if you are planning any capital expenditure.



Capital allowances

Calculating capital allowances

There is an annual investment allowance (AIA) which may be claimed against most forms of allowable plant and machinery.

The main exceptions are for ordinary cars and plant and machinery purchased during a company's final trading period. The allowance is currently £500,000 but is due to reduce for expenditure after 31 December 2015.

There are also some instances when a first year allowance (FYA) may be claimed for the whole cost, such as for certain environmentally-friendly plant.

Rates

If plant and machinery qualifies for an allowance its value (after any AIA or FYA) is added to either the Main or Special Rate pool (unless tax law requires it to be calculated separately). Separate calculations are needed for certain long-life assets (those with an expected life of 25 years or more), some cars and (if you choose) short-life assets.

There are 2 general pools: 1 at a high rate and 1 at a lower rate. Capital allowances mean that the whole cost of an asset will eventually be allowed for tax. A lower rate consequently means that this process will take longer.

The higher rate pool attracts a writing down allowance of 18% a year; the lower rate pool at 8% a year. Where you acquire assets for both pools it is therefore often preferable to use the AIA against the assets that attract the lower rate. Long-life assets must be included in the lower Special Rate pool.

A writing down allowance on its own will never reduce a pool to zero as each year the writing down allowance is a percentage of the written down value from the previous year.

For example, an asset cost £10,000 and qualifies for the 8% writing down allowance:

- in year 1 you claim an allowance of 8%, which is £800 here, giving a written down value of £9,200
- in year 2 you claim 8% of £9,200, which is £736, giving a new written down value of £8,464.

To avoid small figures, HMRC now allows a pool that has fallen below £1,000 to be wholly written off. In our example, if we only had that 1 asset in that pool it would take 28 years for the value to reduce to less than £1,000. By that time you may have long disposed of the asset.

Short-life assets

Short-life assets have an expected life of up to 8 years. These may be left out of the 2 general pools if you wish.

The advantage is that you can claim capital allowances over the expected life of the asset rather than on a reducing basis, allowing tax relief to be obtained much more quickly. This election is commonly made for computer equipment.

We can advise which assets come within the scope and whether it is worth making the election.

Disposing of assets

When an asset is disposed of the proceeds received are deducted from the pool to which the asset was allocated originally. Since pool balances cannot be reduced below zero, in circumstances where the proceeds received from a sale are above the value of the pool a 'balancing charge' is created.

This charge is equal to the excess proceeds received (effectively the potential negative balance that would be produced) and serves to increase taxable profits in order to take back the over claimed allowances.

Similarly, a 'balancing allowance' may arise where a trade ceases with a pool balance greater than zero. This allows for the entire balance remaining to be written off in full.

Rules for cars

Cars are plant and machinery but have some special rules.

Low emission cars can attract a 100% first year allowance. That means that you can write off the whole cost against your taxable profits in the year of acquisition.

Higher emission cars attract a writing down allowance of 18% or 8% depending on their emission figures.

If the car is a company car, the employee could be liable to pay tax on the benefit. The amount is also determined by the car emissions.

Other points to consider

The main rate of corporation tax reduces to 20% from 1 April 2015. Bringing forward expenditure to an earlier period may result in a greater tax saving. The timing of acquisitions can have significant tax consequences.

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

We can advise you on how to calculate capital allowances and how to maximise your capital allowance claim.