

CLIENT MEMORANDUM

CAPITAL ALLOWANCES FOR BUSINESSES

When a business incurs capital expenditure on certain assets, a special relief - called capital allowances - is sometimes available.

The rules have changed radically in the past few years. The purpose of this Memorandum is to describe the reliefs which are currently available, as well as tax-planning opportunities, and to alert clients to the possibilities for maximising tax relief in these circumstances.

Capital allowances are a wide topic, and we obviously cannot give exhaustive coverage of the subject.

It should be noted that, unless otherwise stated, the rules described below apply to sole traders, partnerships and companies. They also apply to investment businesses as well as trading operations.

PLANT AND MACHINERY

The tax law does not define this phrase, but there have been many legal cases over the years in order to determine whether a particular item qualifies.

It should be borne in mind that a number of items can qualify as plant and machinery even though they would not normally be regarded by a layman as falling within that description. Examples upheld by the Courts include reference books, dry docks and grain silos!

As a general principle an item qualifies if it performs an active function in the business. It will probably not qualify if it forms part of the setting in which the business is carried on. For instance, windows and doors do not qualify.

It is necessary to divide plant and machinery into two sub-categories: “general plant and machinery” and “integral features”.

Examples of general plant and machinery:

- Cars (but special rules apply - see below)
- Vans
- Lorries
- Computers and photo-copiers
- Cash registers

- Desks and chairs
- Carpets and curtains
- Safes

Examples of integral features:

- Cold water systems
- Electrical systems (including lighting)
- Heating, ventilation and air conditioning systems
- Lifts
- Escalators

Floors, walls and ceilings will not normally qualify as integral features.

The allowance on plant and machinery are set out below.

Annual Investment Allowances

From 6 April 2008 (or 1 April 2008) for companies), there has been an annual investment allowance of £50,000. Hence, there will be full tax relief if the expenditure on plant and machinery in the relevant period does not exceed £50,000.

In the case of a group of companies, this relief applies to the whole group, not to each company. The sum of £50,000 applies to a whole year, so that if a company has, say, an accounting period of six months, the 100% allowance will apply only to the first £25,000 of expenditure.

First year allowance

A temporary 40% first year allowance was introduced in Finance Bill 2009. This runs for expenditure incurred during the year ending 5 April 2010 for sole traders or partnerships and for expenditure incurred during the year ending 31 March 2010 for companies. This rate, of course, can be claimed only on expenditure which exceeds the £50,000 eligible for the annual investment allowances. The 40% allowance does not cover long-life assets or integral features.

Writing-down allowance

A writing-down allowance of 20% per annum can be claimed for expenditure claimed on or after 6 April 2008 by a sole trader or partnership or on or after 1 April 2008 by a company. This allowance does not apply to integral features nor to long-life plant and machinery. It should be noted that these allowances are given on the “reducing balance” basis.

Example

XYZ Ltd incurs £60,000 on the purchase of lorries in the year to 31 March 2009 and has no capital expenditure or plant and machinery in the year to 31 January 2010.

Year ended 31 March 2009

Annual investment allowance = £50,000.

Year ending 31 March 2010

Writing-down allowance = £2,000
[20% of (£60,000 – £50,000)]

Written-down value carried forward = £60,000 – £50,000 – £2,000 = £8,000.

Integral features

A separate “pool” applies for these, and a writing-down allowance is given of 10% per annum for expenditure incurred on or after 6 April 2008 by a sole trader or partnership, or on or after 1 April 2008 by a company.

As with the 20% writing-down allowance (above), the “reducing balance” basis applies.

Long-life plant and machinery

This is, broadly, an item which, when new, had an expected useful economic life of at least 25 years. If such expenditure does not fall within the 100% annual investment allowance, it will be placed in the 10% special rate pool, along with integral features.

There is however a monetary limit of £100,000 and (subject to certain conditions) the special rate pool will not apply if expenditure on long-life assets in the year is below that limit.

OFFICE BUILDINGS

The capital cost of an office building (or extension) does not normally qualify for capital allowances.

It should however be borne in mind that a large part of the capital expenditure will often qualify as plant and machinery, especially “integral features” (see above).

In certain circumstances allowances may be available under the research and development rules (see below).

RESIDENTIAL BUILDINGS

An investment in a house or flat (or block of flats), does not normally qualify for capital allowances.

However, as part of a Government plan to encourage regeneration of towns and cities, a 100% tax allowance is available in certain circumstances on flats above shops or above other commercial premises. This is to encourage conversion or renovation of vacant or underused space to provide flats for rent. There are a number of criteria to be met, for instance, the property must have been built before 1980 and have no more than five floors.

Although many items in a residential building may be plant and machinery (e.g. electricals, showers and security systems), these are specifically excluded from allowances when part of a residential building. In connection with furnished lettings, the landlord is permitted to claim “depreciation”, calculated as 10% of the rents received (reduced by council tax and water charges, if borne by the landlord). Alternatively, it is possible to obtain tax relief on the net cost of replacement furnishings. Also, the cost of replacing single glazing with “equivalent” double glazing can be treated as allowable repairs instead of capital expenditure.

If the residential accommodation forms part of a trading activity, e.g. a nursing home or hotel, the plant and machinery allowances will be available in the normal manner. There were also special reliefs on certain hotel buildings, but these are being phased out from April 2008.

BUSINESS PREMISES RENOVATION ALLOWANCE

This is a 100% allowance which was introduced on 11 April 2007, and applies to expenditure involved in bringing disused commercial premises back into commercial use. There are a number of conditions which must be met, the main one being that the premises must be located in certain specified “disadvantaged” areas.

AGRICULTURAL BUILDINGS

The writing-down allowances are being phased out between now and April 2011. There will be no balancing adjustment on a disposal on or after 21 March 2007, but the buyer will be able to claim allowances based on the vendor's writing-down allowances.

INDUSTRIAL BUILDINGS

The allowances on these buildings are being phased out along similar lines to agricultural building allowances. It may be possible, in certain circumstances, to obtain plant and machinery or research and development allowances as mentioned under "Office Buildings" above.

ENTERPRISE ZONES

There was a generous regime of allowances on the cost of commercial buildings (but not the land element) located in enterprise zones. The ten year life-span of all enterprise zones has now expired, but it is still possible to benefit from these allowances in some cases where the contract for expenditure was entered into during the ten year period. These allowances will cease for expenditure after 31 March 2011 for a company (or 5 April 2011 for other taxpayers).

RESEARCH AND DEVELOPMENT ETC

There are a number of allowances available for certain kinds of expenditure on research and development, as well as for expenditure connected with energy efficiency or water saving. These reliefs can be very valuable: in some cases it may be possible to obtain 100% relief on the cost of a relevant building. The rules are complex and are still being formulated by the Government. Please let us know if you require detailed information.

CARS

Cars are technically "plant and machinery", but they are specifically excluded from the above rules.

There used to be restrictions on capital allowances for cars costing more than £12,000, but these have been abolished for expenditure incurred on cars on or after 6 April 2009 (1 April 2009 for companies). Expenditure on cars on or after the dates mentioned above will now be added to the 20% plant pool if the cars have Co2 emissions of 160g/km or less, or to the 10% pool in other cases. If a car is owned outside a company and has an element of private use it will fall into its own individual pool; this will qualify for 10% or 20% writing-down allowances, as appropriate.

FOR GENERAL INFORMATION ONLY

Please note that this Memorandum is based on legislative proposals which are currently going through Parliament. It is possible that the details will be amended in the course of the Parliamentary process. Please let us know if you desire an update on the position at any stage.

The Memorandum is not intended to give specific technical advice, and it should not be construed as doing so. It is designed to alert clients to some of the key issues.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.