

# Capital allowances

## Overview

Most day to day business expenses can be deducted from business income when calculating your taxable profits. However, the rules are different for 'capital' expenditure. 'Capital allowances' is the term used to describe the allowances which allow businesses to secure tax relief for certain capital expenditure. Most 'capital' items, such as computer equipment, vehicles, machinery etc last for more than a year or so. The tax rules do not allow you to automatically deduct the full cost of such items in one go and different rules apply to different types of capital expenditure. In some cases, no tax relief is available at all even though you may have spent the money solely for business purposes.

This guide provides an overview of the main types of capital allowances that can be claimed and is aimed at businesses with relatively straight forward tax affairs.

Capital allowances are available in respect of:

- Most 'plant and machinery' used for business purposes;
- Certain building works - for example converting space above commercial premises to flats for renting;
- Certain research and development expenditure.

Your entitlement to claim capital allowances is usually unaffected by how you pay for the items in question. For example, if you buy an item on hire purchase you can claim capital allowances based on the full normal cost of the item. The interest you pay and other charges are not part of the capital cost of the item but can usually be counted as deductible business expenses.

If you simply rent capital equipment, and do not secure ownership of the items, no capital allowances can be claimed. Instead the payments due, under what is usually called an 'operating lease', are simply deductible as a normal business expense.

## Plant and machinery

The official term 'Plant and Machinery' (P&M) includes items such as cars, vans, machines, equipment, computers, furniture and other similar items used by a business.

Some of the rules related to P&M depend on the nature of the expenditure and how much money has been spent on P&M during the accounting period. There are also special rules to provide tax relief for items of P&M you used privately before using them in your business and items that you only partly use for business purposes.

## Annual investment allowance (AIA)

The AIA is available to all businesses regardless of size. This AIA allows businesses to write off 100% of the cost of qualifying P&M, up to the allowed maximum, against taxable profits.

The limit was permanently set at £200,000 from 1 January 2016. There is a temporary cap in place of £1,000,000 until 31 March 2023. From 1 April 2023, the AIA is expected to revert back to £200,000 after the temporary increase comes to an end.

## Writing down allowances

For plant and machinery expenditure that exceeds the AIA and which does not qualify for a First-Year Allowance (see below), a standard 18% Writing Down Allowance (WDA) is available. This is based on the cost of the items in the year they are acquired.

## First-year allowances

A new temporary FYA “super-deduction” and an FYA “special rate” deduction were introduced from 1 April 2021. These new FYA’s allow businesses to increase the tax relief they can claim for qualifying investments in plant and other equipment. The new reliefs will apply until 31 March 2023. The super-deduction will mean that assets will qualify for tax relief based on 130% of the actual cost of expenditure incurred. Assets that qualify for the special rate relief will qualify for the 50% FYA.

The existing 100% FYA will continue to apply for certain expenditure such as designated freeport sites and zero-emission good vehicles.

## Special cases

Most plant and machinery is treated in a standard way for capital allowances, however there are special rules for expenditure on:

- Cars.
- Long-life assets.
- Short-life assets.
- Integral features of buildings and thermal insulation.
- Assets bought by businesses and then leased out.

## Cars

Qualifying expenditure on cars must be allocated to one of two general P&M pools of expenditure. Which pool is appropriate depends on the car’s CO2 emissions.

Cars that have an element of non-business use, by the self-employed, must be allocated to a single asset pool to enable the private use adjustment to be made. New and unused electric or zero emission cars benefit from 100% capital allowances.

## Short-life assets

There are special rules when a business purchases equipment that it expects to keep for a short time or that is expected to wear out quickly.

If the life of the asset is ‘short’, businesses can choose to calculate the capital allowances outside the main pool. This will generally mean more tax relief but only when the assets are written off, scrapped or sold.

## Long-life assets

This term refers to assets with an expected useful life of more than 25 years. The tax allowance here is set at 6% (2021-22: 6%) of the written down value each year with all expenditure on long life assets being added to a special 6% rate pool.

## **Integral features of buildings and thermal insulation**

The same relief as for other long life assets is also available for the cost of new or replacement 'integral features' of a building.

Such features are:

- Cold water systems.
- External solar shading.
- Lifts, escalators, and moving walkways.
- Active facades electrical systems (including lighting systems).
- Space or water-heating systems, powered systems of ventilation, air cooling or air purification, and any floor or ceiling comprised in such systems.

Businesses can also claim the 8% allowance each year for expenditure on installing thermal insulation in all existing buildings used for any qualifying business purpose - other than if it's a residential property business.

## **Research and development**

R&D tax credits were introduced for small and medium sized enterprises (SMEs) in 2000 and for large companies in 2002. R&D credits are a CT relief which were introduced to encourage innovation and enterprise within the UK economy. SMEs can currently claim R&D tax credits of 230% for expenditure incurred on or after 1 April 2012.

Large companies can claim a 13% (2021-22: 13%) R&D expenditure credit for qualifying expenditure.

The rules as to what qualifies in this regard are complex. In general, however, a project qualifies as R&D if:

- It seeks to achieve an advance in science or technology.
- The research is relevant to the business.
- The business is of a trading nature as distinct from someone working in a profession or vocation.

## **Structures and buildings allowance (SBA)**

A new structures and buildings allowance (SBA) was introduced as part of the autumn Budget 2018 measures. The SBA provides tax relief for qualifying capital expenditure on new non-residential building where all contracts for the physical construction works are entered into on or after 29 October 2018. The relief does not include the cost of land or dwellings. The SBA is set at 3% (2021-22: 3%) calculated on a straight line basis.

## **Assets leased out**

In certain circumstances businesses can claim capital allowances for assets they own and lease to other businesses.

## **Private use**

This section is only relevant if you operate your business as a sole trader or partnership and is therefore not relevant if your business is a limited company.

Where a business asset is used partly for private purposes the entitlement to capital allowances are restricted. The asset is not included in any pool but is the subject of a separate calculation.

The allowances are computed in the normal way so can in theory attract the 100% AIA or the relevant writing down allowance.

However, 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.

### **Claiming capital allowances**

All claims for capital allowances are made through the business's annual tax returns. You do not need to claim the full amount of the available allowance. You might choose to limit your claims to capital allowances to avoid other allowances or reliefs being wasted.

### **How we can help**

We would welcome the opportunity to assist you in maximising your claims to capital allowances. We can also help you arrange your business expenditure generally so as to maximise your entitlement to secure tax relief.