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**Getting to grips with
capital allowances**

What are capital allowances, and what can they do for your business?

Your route to tax relief

For tax relief purposes, business expenditure is either treated as revenue expenditure or capital expenditure. This is the first big divide. It involves asking if the expenditure provides enduring value to the business (capital); if it should be considered as a repair (revenue) or improvement (capital); and whether only part of the asset is being replaced (likely to be revenue) or the entirety (capital). Technically, revenue expenditure can be deducted from income in the year it's incurred, which accelerates tax relief: but capital expenditure works on different rules. Capital allowances thus provide a way to get tax relief for the purchase of capital equipment. The allowances are treated as a deduction when calculating taxable profits.

The rules depend on what you are buying, sometimes the method of finance you use for your purchase, and when the purchase is made. Some depend on how long the asset will last; others on when you dispose of it. Not all capital expenditure qualifies for capital allowances. There are specific categories it must fit within. And the amount of relief can vary, depending on the category. The Structures and Buildings Allowance (SBA), for example, gives 3% relief, while the new super-deduction gives 130%.

Which allowances will most benefit your business can be a finely balanced decision. Planning usually involves reviewing the replacement cycle alongside all the possible allowances available, then claiming those eligible for the most tax relief, at the earliest date. The regime has always been complex, but recent changes - like those in the Budget - make it even more so.

Categories of expenditure for capital allowances

The categories relevant to most businesses are:

- plant and machinery
- structures and buildings.

But there are also allowances available for activities involving:

- research and development
- dredging
- extracting minerals
- patents and know-how (for unincorporated businesses: companies are provided for under different rules).
- freeports and, for expenditure to 31 March 2021, enterprise zones.

Please contact us to explore these in more detail.

Thinking about plant and machinery

Plant and machinery allowances (PMAs) can be claimed by companies, individuals or partnerships. To be eligible:

- they must carry on a trade, property business or other qualifying activity
- expenditure must be capital expenditure on plant or machinery wholly or partly for the purpose of the qualifying activity
- the business should own the plant or machinery as a result of the expenditure.

Which assets?

PMAs can be used for most tangible assets used in the course of business. This includes assets like machinery, furniture, computers, and other business equipment. Integral features can also qualify, as can some fixtures, such as fitted kitchens or bathroom suites. Alterations to a building to install other plant and machinery can be eligible, but not repairs.

Cars fall under the plant and machinery heading, though they have bespoke rules. And as carbon emissions come increasingly under government scrutiny, tax breaks exist for zero emission and ultra low emission vehicles (below).

What doesn't qualify?

Not all assets fall into the plant and machinery category. There are particularly complex rules

for assets that are part of a building or structure, for example, and we would be pleased to advise further here. Generally, PMAs exclude: leased assets: buildings (including doors, gates, shutters, mains water and gas systems): land and structures (such as bridges, roads and docks).

The Annual Investment Allowance

For assets eligible for PMAs, the most effective tax relief will usually come via the Annual Investment Allowance (AIA). The AIA provides a 100% deduction for the cost of most plant and machinery - but does not cover cars. There is an annual cap, currently £1 million, and for many businesses, this gives immediate tax relief adequate for all capital spending.

In addition to PMAs, there are also 100% first-year allowances. These are not available on every type of asset: at present, they mainly cover low emission vehicles (below). Where the AIA/first-year allowances have been used, or are not available, qualifying expenditure may be pooled and writing down allowances (WDAs) used. WDAs give relief at 18% annually, or 6%, depending on the type of asset involved.

Recent developments

Business vehicles: new tax year, new rules

The 100% first-year allowance for new cars with low carbon dioxide emissions is extended until 31 March 2025. The qualifying emissions threshold falls from 50g/km to 0g/km for expenditure on or after 1 April 2021. A similar extension for zero emission goods vehicles runs to 2025. For income tax purposes, expenditure must be on or before 5 April 2025, and for corporation tax, 31 March 2025. Please contact us to discuss the tax benefits available.

AIA: plan now for lower limit

Currently at an all-time high, the AIA falls back to £200,000 from 1 January 2022, and transitional rules apply to accounting periods straddling this date. Where expenditure is incurred on or after 1 January 2022 and before the end of the accounting period, the rules may limit how much

qualifies for the AIA. The timing of expenditure is thus particularly important. Do talk to us in advance about your plans so we can help you maximise tax relief.

Structures and Buildings Allowance (SBA)

The SBA was introduced in 2018 for expenditure on business-related buildings and structures. It now provides an annual 3% writing down allowance, on a straight-line basis. It generally runs for 33 and 1/3 years from the building's first use. An enhanced version of the SBA is available for freeports.

The SBA is designed to promote investment in the construction of new structures and buildings meant for commercial use; the necessary works to bring them into existence, and the improvement of existing structures and buildings. It includes the cost of converting existing premises for use in a qualifying activity, but neither land or dwellings are eligible.

Budget measures

The Budget introduced the super-deduction and a first-year special rate allowance (SRA). Both are time limited.

The super-deduction:

- is available only to companies, not unincorporated businesses
- relieves expenditure on qualifying plant and machinery incurred between 1 April 2021 and 31 March 2023
- contracts entered into before 3 March 2021 are not eligible, even if expenditure is incurred after 1 April 2021
- gives 130% relief for most new plant and machinery that would otherwise qualify for 18% main rate writing down allowances. It could therefore be used for most plant and machinery other than cars and integral features.
- is not available for second-hand assets, or certain other assets excluded by capital allowance rules, such as expenditure on most leased plant and machinery
- additional conditions apply for hire purchase and similar contracts
- special disposal rules apply

- complex apportionment is needed for accounting periods straddling 1 April 2023.

The SRA has restrictions similar to the super-deduction. It is available only to companies, and within the same timescale as the super-deduction. It gives 50% first-year relief for qualifying expenditure that would otherwise be eligible for 6% special rate WDAs. It can thus be used for special rate pool assets: integral features, such as electrical systems, lifts and space or water heating systems; and long life assets. Special disposal rules apply.

Pros and cons

A business planning major capital expenditure, that can bring it within the life of the super-deduction, may see significant benefit.

The attractions of the super-deduction are obvious. Immediate, first-year tax relief, potentially cutting tax bills by up to 25p for every £1 spent. No cap to the amount of expenditure that can qualify. And relief in excess of the purchase cost of the asset.

But there are downsides. One key issue is what happens when the assets are disposed of. With the super-deduction and SRA, an immediate 'balancing charge' arises on any sale proceeds. This is then taken into account when calculating taxable profits and can work to increase the tax bill. If disposal takes place before the super-deduction regime ends on 31 March 2023, the charge can be increased to 130%, clawing back relief already given. We can advise if the new allowances will work in your favour.

Change since the budget

As originally announced, the super-deduction and SRA excluded leased plant and machinery. Commercial landlords were among some of the businesses impacted by this. But a recent amendment to the rules extends eligibility to 'background' plant and machinery in leased property. This includes assets like a lift in a 20-storey office block: items without which the building wouldn't function. Most background

plant and machinery falls into the integral feature category, and so is more likely to qualify for the SRA than the super-deduction. Please contact us for further information.

Super-deduction planning points

- The timing of asset acquisitions and disposals is very important. We can work with you to establish your likely replacement cycle in order to optimise tax relief.
- Interaction with the existing reliefs such as the AIA and research and development allowances may need consideration. We can review this for you to ascertain the most appropriate claims.
- The temporary provisions on carrying back losses may also merit attention. It may be that using the super-deduction could create or enhance such a loss, generating a tax refund.
- How do the AIA, super-deduction and SRA interact for you? This may be particularly relevant if you plan a package of major expenditure in the window after the AIA drops back to £200,000, but before 31 March 2023, when the super-deduction, and particularly the SRA, end.
- Reviewing the increase to the rate of corporation tax from 1 April 2023, when the super-deduction ends. As the rate of corporation tax increases, so the AIA will give tax relief at 25%, rather than the current 19%. We can calculate the implications of this for your business, weighing up relief now at 19%, as against relief at 25% from 2023, in the light of projected profitability and cashflow.
- Accurate records are key to substantiating claims, and calculating balancing charges, and will be particularly important to claims using the super-deduction. We can advise on what is needed.

Working with you

Advance planning will inevitably create the best solutions, so do please get in touch when capital expenditure is on the agenda. We look forward to working with you to optimise the tax relief available.