

CARBON ACCOUNTANCY
CHARTERED ACCOUNTANTS



KEY GUIDE

Tax allowances for business investment

Introduction

MAKING THE MOST OF YOUR INVESTMENT

The current high level of annual investment allowance for plant and machinery means that for many businesses there is no immediate difference between capital and revenue expenditure. For companies, the situation might be even better than this because of the introduction of a 130% super-deduction which is available until 31 March 2023. However, where such reliefs are not available, it is important that you benefit from any other available tax relief for capital expenditure.

With the enhanced £1,000,000 plant and machinery annual investment allowance limit also set to come to an end on 31 March 2023, the government is considering a range of possible reforms to best support future business investment. The March Spring Statement covered five changes to capital allowances that the government could potentially make.

Contents



CAPITAL ALLOWANCES

The reliefs available for your business investments



PROPERTY

The reliefs available when constructing, purchasing and letting property



POOLED EXPENDITURE

Writing down allowances and expenditure over the limits



CLAIM VALUE AND TIMING EXPENDITURE

How much you can claim relief for and when you should claim it



The main types of capital allowances

You cannot deduct capital expenditure or depreciation when calculating your taxable profits. Instead, you can claim capital allowances if you are in business as an individual, a partnership, a company or as a trustee of a trust. Allowances may also be available if you let property. The most important allowances are those for plant and machinery, but allowances are also available for:

- commercial property;
- research and development expenditure;
- patent rights and know-how; and
- mineral extraction, cemeteries and crematoria, and dredging.

Allowances are normally given as a deduction in calculating your trading profits or the profits of a property letting business.

SUPER-DEDUCTION

For a two-year period from 1 April 2021 to 31 March 2023, companies can benefit from enhanced capital allowances when they purchase plant and machinery:

- For expenditure that would fall into the main pool, there is a 130% super-deduction. This means that for every £100 of expenditure, a first-year allowance of £130 is available.
- For expenditure that would fall into the special rate pool, there is a 50% first-year allowance.

Enhanced capital allowances are not available to sole traders or partnerships.

Only expenditure on new plant and machinery qualifies, not expenditure on second-hand or used assets. Cars do not qualify.

Complexity

The introduction of the enhanced allowances has made planning for capital allowances somewhat more complex, especially as the new allowances are only available for two years:

- For expenditure falling into the main pool, the 130% super-deduction will normally be preferable to the 100% annual investment allowance.
- However, for expenditure falling into the special rate pool, the 100% annual investment allowance should be claimed in preference to the 50% first-year allowance.
- The 130% super-deduction (but not the 50% first-year allowance) will be reduced using time-apportionment if an accounting period straddles 1 April 2023.
- The disposal rules are quite complicated. For example, if the super-deduction is claimed and the asset then disposed of in an accounting period ending before 1 April 2023, the disposal proceeds will be increased by a factor of 1.3.
- Given the higher rates of corporation tax that are to apply from 1 April 2023 (25% where profits exceed £250,000), it is probably not worth bringing forward capital expenditure plans in order to claim the 130% super-deduction. Reducing profits taxed at 25% will be more beneficial. There is also the possibility that the government will introduce a similar enhanced allowance once the super-deduction comes to an end.

Given that enhanced allowances are only relevant for companies, any further interaction with the other plant and machinery capital allowances is not covered in this guide.

100% RELIEF FOR PLANT AND MACHINERY

Your business can qualify for 100% tax relief in the year of purchase on the first £1,000,000 of expenditure on most types of plant and machinery by claiming the annual investment allowance (AIA). This means that there is no immediate difference between capital and revenue expenditure.

- The £1,000,000 limit is only temporary, although it has recently been extended up to 31 March 2023. Previously the limit was £200,000 a year, and it is set to revert to this level from 1 April 2023 (although one of the possible reforms being considered by the government is setting the AIA at a permanent level of £500,000). If your accounting period will span 1 April 2023, your maximum AIA for the period will depend on the proportions of the period falling before and after that date.
- The AIA is not available for expenditure on cars. Cars are defined as vehicles suitable for private use (including motor homes) and not built for transporting goods. Therefore, the AIA is available for expenditure on lorries, vans (but probably not modified crew cabs) and trucks and also motorcycles.
- Companies that are part of a group are entitled to only one AIA between them, but it can be divided as they wish. The same restriction applies if you have two related businesses that are run from the same premises.

First-year allowances

100% relief is also given where a first-year allowance is available. This is a separate allowance for expenditure on:

- new zero-emission cars;
- charge-point equipment for electric vehicles;

- new zero-emission goods vehicles, such as electric vans; and
- plant and machinery expenditure incurred within certain designated enterprise zones (those where there is a strong focus on manufacturing) and also designated tax sites in freeports (for expenditure incurred from when the tax site is designated until 30 September 2026). Five of the eight planned freeports in England are now up and running.

EXAMPLE

Working out the AIA

Birch Ltd draws up accounts to 30 June. For the year ended 30 June 2022, the company's maximum AIA will be the full £1,000,000. For the year ended 30 June 2023 (assuming the AIA reverts back to a level of £200,000 from 1 April 2023), Birch Ltd will have a maximum AIA of £800,000 calculated as $9/12 \times £1,000,000$ (for the period 1 July to 31 March 2023) + $3/12 \times £200,000$ (for the period 1 April to 30 June 2023). The maximum AIA that can be claimed in respect of expenditure during the period 1 April to 30 June 2023 is £50,000 ($3/12 \times £200,000$), despite the overall maximum of £800,000.

Planning point

The increase in the AIA to £1,000,000 is only temporary, so if you are planning an extensive programme of capital expenditure it will probably make sense to incur as much of this as possible prior to 31 March 2023. However, make sure you keep an eye on government announcements given the current uncertainty over what will happen to the limit from 1 April 2023.

It is also beneficial to incur expenditure just before, rather than just after, your accounting period end. You will then benefit from tax relief on the expenditure one year earlier.



POOLED EXPENDITURE

Any expenditure over your AIA limit, or not qualifying for a first-year allowance, is 'pooled' into one of two pools. A writing-down allowance (WDA) is given every year on the balance of unrelieved expenditure in each pool. Which pool expenditure goes into depends on the type of asset.

When you sell a pooled asset, or an asset on which you have claimed AIA or a first-year allowance, the proceeds are deducted from the relevant pool balance before calculating the WDA. If the proceeds are greater than the pool balance, the excess – called a balancing charge – will be added to your profits.

A pool balance of £1,000 or less can be written off in full.

There are two rates of WDA:

- Assets in the main pool qualify for WDA at 18%. Cars with CO₂ emissions between 1g/km and 50g/km are included in this pool.
- The WDA is 6% for assets in the special rate pool. This pool consists of expenditure on integral features of a building, thermal insulation, long-life assets (those with a useful economic life of 25 years or more), and cars with CO₂ emissions above 50g/km.

EXAMPLE Pooling

Oak Ltd bought used machinery costing £1,270,000 during the year ending 31 December 2022. It can claim AIA on £1,000,000 of the expenditure (the super-deduction is not available for used assets) and the other £270,000 will be added into the main pool. The WDA is £48,600 (£270,000 at 18%), with the remaining balance of £221,400 being carried forward to the year ended 31 December 2023, where a further WDA of 18% can be claimed on this brought forward figure.

As far as the main and special rate pools are concerned, a balancing allowance can only arise in the year that the business ceases. In the final year of trading, sale proceeds are deducted from the pool balance (no WDA or AIA is given). If sale proceeds are less than the balance then there will be a balancing allowance, and if the proceeds are greater there will be a balancing charge.

Planning point

The 100% first-year allowance is only available if a zero-emission car is bought new. The extra tax saving from having the 100% allowance could mean that it is more beneficial overall to buy new rather than second-hand.

EXPENDITURE THAT IS NOT POOLED

Some expenditure is not pooled. This is mainly expenditure on short-life assets and on assets which you use partly for private purposes. This will include your car if you are in business as a sole trader or partner – but it does not include cars available for the private use of employees, because such cars are pooled.

Short-life assets are those items that depreciate rapidly, such as computers, where you can make an election allowing you to claim faster allowances. An asset has a short life if it is not expected to last more than eight years after the end of the period in which it is bought.

Electing for short-life assets treatment is only worthwhile if the expenditure does not qualify for AIA, i.e. because you have already exhausted your AIA limit for the current period.



EXAMPLE

Short-life asset

Bevin, Bird and Boyd, a partnership, bought computer equipment costing £40,000 on 15 July 2022. The computer equipment has a life of 18 months, after which it will be scrapped. The partnership has exhausted its AIA limit for the year ended 31 March 2022 against other plant and machinery purchases.

If no short-life asset election is made, the computer equipment will be added into the main pool with WDAs at the rate of 18% given each year.

If an election is made, the computer equipment will not be pooled. The WDA for the year ended 31 March 2023 will be the same (£40,000 at 18% = £7,200), but a balancing allowance of £32,800 (£40,000 - £7,200) will then be given in the year ended 31 March 2024 when the computer equipment is scrapped. The cost is therefore effectively written off over the 18-month life of the asset.

Allowances for assets that you use partly for private purposes are restricted in accordance with the proportion of non-business use.

EXAMPLE

Private use of an asset

Clare is in business as a sole trader. Her car (CO₂ emissions are 45g/km) cost £15,000, with 25% of the mileage being for private purposes. The WDA is restricted to 75% of the normal rate, so in the year of purchase Clare is entitled to a WDA of £2,025 (£15,000 at 18% x 75%).

A balancing charge or allowance (where sale proceeds are less than the unrelieved expenditure) will arise when a non-pooled item is sold.

Planning point

If you personally retain assets after cessation, they will be treated as sold at their open market value – increasing the amount of tax that you will have to pay for the final year of trading. Without any compensating sale proceeds, you will need to plan for this tax cost.

POSSIBLE REFORMS

In his March 2022 Spring Statement, the Chancellor put forward five potential ways in which capital allowances for plant and machinery could be reformed when the current



130% super-deduction and the £1,000,000 AIA limit come to an end on 31 March 2023. These are:

- Permanently increasing the level of AIA to £500,000;
- Increasing the WDA from 18% to 20% for main pool expenditure, and from 6% to 8% for special rate pool expenditure;
- Introducing a first-year allowance of 40% for main pool expenditure, with an allowance of 13% for special rate pool expenditure;
- Introducing an additional first-year allowance of 20% on top of standard WDAs – effectively giving relief for 120% of expenditure; and
- Introducing full expensing so that capital expenditure is simply written off as incurred.

LONG AND SHORT ACCOUNTING PERIODS

If your accounting period is less than 12 months, the amount of AIA and rate of WDA are reduced accordingly. So, for a four-month period the AIA is £333,333 (£1,000,000 x 4/12) and the rates of WDA are restricted by 4/12.

For individuals and partnerships, the same principle normally applies to periods longer than 12 months. For a 15-month accounting period the AIA would be increased by 15/12 and the rates of WDA are increased by 15/12.

However, a company cannot have an accounting period of longer than 12 months – such a period must be split into two. So, for a 15-month period, there will be a 12-month period with the normal AIA and rates of WDA, and a three-month period



with reduced allowances. This treatment also applies if a sole trader or partnership has an accounting period longer than 18 months.

First-year allowances are always given in full, regardless of the length of the accounting period.

CASH BASIS

Capital allowances are generally not relevant if you use the cash basis (available to individuals with an annual income up to £150,000) to calculate your trading profit. Expenditure on business assets such as machinery, computers and vans is simply deducted as an expense, although capital allowances may still be relevant when it comes to cars.

PARTNERSHIPS

Capital allowances must be claimed by the partnership collectively in the partnership tax return, not by the partners in their individual returns. Partners may often own business assets individually, especially cars, but capital allowances must be claimed in the partnership return. This means that a partner with an expensive car effectively shares some of their allowance with other partners who may have less expensive cars.

THE VALUE TO USE

With an outright purchase, you can claim capital allowances based on how much the item cost you, including any costs directly related to the acquisition. However, you cannot claim for interest or finance costs as these will be deducted as a normal business expense. The same principle applies if you buy an asset on hire purchase or by an alternative finance method – you can only claim capital allowances on the cost of the item itself, not the interest or other charges.

If you are VAT registered, you claim capital allowances on the net of VAT cost of the asset. However, if you are not VAT registered you will claim capital allowances on the total price

paid, including the VAT element. The same principle applies if you are VAT registered but cannot reclaim all of the VAT – any irrecoverable VAT is included in the figure on which you can claim capital allowances. VAT is irrecoverable where cars are not used 100% for business purposes, and also where you make exempt supplies.

If you receive a business asset by way of a gift, then you can claim capital allowances based on the asset's market value when you start using the asset in your business.

When an asset is sold, the proceeds figure to be brought in is restricted to the original cost should you sell an asset for more than you paid for it. Proceeds will be net of VAT if you are VAT registered.

EXAMPLE VAT and business use

Martha, who is registered for VAT, purchased a car on hire purchase. The cost of the car was £15,000, including VAT of £2,500, and the total price to be paid under the hire purchase agreement is £17,600. Unless the car is used 100% for business use, capital allowances will be based on the VAT inclusive cost of £15,000.

Planning point

Don't forget, when you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business.

WHEN IS EXPENDITURE INCURRED?

Expenditure is normally treated as incurred on the date when your obligation to pay becomes unconditional. However, there is an exception to this general rule. If you do not have to pay within four months, expenditure is not treated as incurred until the payment date.

When you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business. The expenditure is treated as incurred on the date you start to trade, and assets will be brought in at their market value on that date.

Restricting capital allowance claims

A very useful feature of capital allowances is that claims can be restricted to meet your personal circumstances.

PROBLEMS WITH BUILDINGS

You cannot generally claim plant and machinery allowances in respect of an asset which is part of your premises or the setting in which you carry on the business, such as floor tiles.

EXAMPLE Restricting a claim to capital allowances

If your trading profit before capital allowances for 2022/23 will be £16,000, and the maximum capital allowances claim is £10,000, then you might claim just £3,430. The resulting profit of £12,570 would then exactly be covered by your personal allowance of £12,570. Or you might decide to claim a higher amount of capital allowances, since self-employed national insurance contributions are payable where profits exceed £11,908 and tax credits start to be withdrawn once income exceeds £6,770.

The distinction between 'plant' and 'setting' can be a fine one, although certain integral features of a building qualify for allowances regardless of the distinction – for example, electrical, water and heating systems, lifts and escalators.

Common items that usually qualify as plant or machinery include computers, office and shop furniture, machinery, tools and vehicles.

Second-hand buildings

Establishing the amount of expenditure that qualifies as plant and machinery can be difficult if you purchase a building, especially if the building is purchased second-hand. With a second-hand building, it is generally necessary for you and the seller to make a joint election regarding the value to be placed on the integral features. Also, no allowances will be available unless the seller has pooled the expenditure, even where the seller has never claimed any capital allowances.

STRUCTURES AND BUILDINGS

There was previously no relief for the cost of buildings unless expenditure qualified as plant and machinery. However, if you buy commercial property where the construction contract was signed on or after 29 October 2018, the structures and buildings allowance (SBA) can now be claimed. From 1 April 2020 (6 April 2020 for unincorporated businesses), relief is given at an annual flat rate of 3% over a

32½-year period (33 years and four months), with a separate SBA given for each structure or building qualifying for relief. Prior to 1 (or 6) April 2020, the annual allowance was 2%.

EXAMPLE Structures and buildings allowance

Elm Ltd bought an office building (not situated in a freeport) from a developer on 1 April 2022 for £800,000, with £350,000 of this being the value of the land. The building was immediately brought into use for Elm Ltd's trade. For the year ended 31 March 2023, Elm Ltd can claim an SBA of £13,500 ((£800,000 – £350,000) at 3%). The claim will continue for the next 32½ years unless the office building is sold before then.

Planning point

If purchasing a second-hand building, the amount of expenditure which will qualify as plant and machinery, and whether the structures and buildings allowance will be available, should be established early on in the negotiations. It will be relevant when deciding on the price to pay, and could be the deciding factor if there is a choice of buildings.

- Offices, retail and wholesale premises, walls, bridges, tunnels, factories and warehouses can all qualify for relief.
- The cost of land, legal fees, stamp duty and the cost of obtaining planning permission are excluded, as is any part of a building used as a dwelling house. Work spaces within domestic settings, such as home offices, also do not qualify for relief. Expenditure that qualifies as plant and machinery cannot also qualify for the SBA.
- If you buy an unused building that has been constructed by a developer, then the qualifying expenditure will be the price that you pay less the value of the land.



- It doesn't matter if the property is situated overseas as long as your business is within the charge to UK tax.
- Relief is also available for the cost of converting or renovating a property. The expenditure qualifies for its own separate 3% write-off over the next 33½ years.
- The allowance will cease to be available if a structure or building is demolished.
- The rate of SBA is 10% for qualifying properties situated in tax sites in Freeports where the property is brought into use by 30 September 2026.

LET PROPERTY

Capital allowances are not available for assets such as tables, beds, carpets, cookers and washing machines used in a dwelling. The exception is if your property qualifies as a furnished holiday letting, since the short-term nature of holiday lets makes this more akin to running a business.

EXAMPLE

Replacement furniture relief

Joe purchased a house on 6 April 2022 and let it out throughout 2022/23. During April 2022, he furnished the house with a cooker costing £460, a washing machine costing £370 and floor coverings costing £2,400.

The cooker was sold during January 2023 for £90 and replaced with a similar model costing £500. The washing machine was scrapped, with nil proceeds, during March 2023. It was replaced by a washer-dryer costing £660, although the cost of a similar washing machine would have been £380.

No relief is available for the initial cost of the cooker, washing machine and floor coverings. Relief for the replacement cooker is £410 (£500 - £90). Relief for the washer-dryer is restricted to £380, since no relief is given for that part of the cost that represents an improvement over the original washing machine.

Planning point

Make sure that you are claiming for the cost of replacement furniture and furnishing. A property does not need to be fully furnished for relief to be available.

However, replacement furniture relief allows you to claim a 100% deduction for the cost of replacing furniture, furnishings, appliances and kitchenware provided for a tenant's use. No relief is given for the initial cost of furnishing a property or for any part of the cost representing an improvement. The amount of relief is reduced by any proceeds from selling the old asset which has been replaced.

RESEARCH AND DEVELOPMENT EXPENDITURE

If you incur capital expenditure on research and development (R&D) related to a trade you are carrying on (or for a trade you are about to carry on), the expenditure can qualify for a 100% allowance. It should be noted that:

- The cost of any land does not qualify.
- If you subsequently sell an asset on which relief has been given, the sale proceeds will be added to your trading profits.

There is a separate R&D tax relief for revenue expenditure.

OTHER ALLOWANCES

Capital allowances for patent rights and know-how are given at 25% on the balance of unrelieved expenditure at the beginning of the year.

Mineral extraction allowances are given at 25% on certain expenditure on the acquisition of minerals or rights over them, and pre-trading exploration expenditure.



HOW WE CAN HELP

If you are in business or you let property, we can advise you about what capital allowances you can claim and how you might be able to maximise the allowances available, especially in regard to the new super-deduction. We will also make sure you are kept abreast of future developments.

People who buy commercial property often do not appreciate the extent to which they can claim plant and machinery allowances for fixtures and equipment in the building. We can help you identify qualifying costs, and you may be entitled to the SBA.

We can also advise you on the tax implications of different methods of acquiring assets, for example outright purchase or leasing, and on the best timing of your purchase or disposal. You should speak to us at an early stage in your planning.

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