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Capital Allowance Essentials 2009/10

Capital allowances are the set of tax rules which determine the tax deduction you are entitled to when you incur expenditure on capital assets used in a business. The rules affecting 'plant and machinery' are the most important area for the majority of businesses. Significant changes were made to these allowances commencing in April 2008. Additional changes are now included in the Finance Bill 2009, particularly in relation to car expenditure.

This briefing provides you with an up to date summary of all the key changes to the capital allowances regime. A number of these changes have become operational over the last 12 months but further changes came into effect from April 2009 particularly in relation to business cars.

It covers the tax relief position on plant and machinery including cars for different types of business structure. A consideration of the tax position of leasing or hiring cars is included due to changes in the rules. Selected building expenditure aspects for the next year are also outlined.

What qualifies as 'plant and machinery' expenditure?

Relevant assets have always included machines, equipment, furniture, computers, cars and other motor vehicles. However, a key change under the new rules is the introduction of a new category of plant and machinery known as 'integral features'.

Integral features includes lifts, electrical and lighting systems, air conditioning and heating systems. It does not include kitchen and toilet fixtures which will generally continue to be treated as normal plant and machinery. All expenditure belonging to the new group is allocated to a separate special rate pool for capital allowances. If your business incurs expenditure on plant which was previously treated as long life plant, this is also now allocated to the same special rate pool.

Replacement

Expenditure on the repair of an integral feature may be reclassified as a capital purchase of plant and machinery rather than an automatic accounts deduction. This will happen if the repair amounts to more than 50% of the cost of replacing the whole asset. Detailed records of maintenance costs and timings may be needed in the case of common assets like lifts, electrical wiring and air conditioning systems to ensure the correct tax treatment.

Comment

Some integral features previously qualified as ordinary plant but some were classified as building expenditure and often did not qualify for any tax relief so this aspect of the change is beneficial.

However, the introduction of this new category does increase the analysis and records required when buildings are purchased, as capital costs will need to be allocated between building, plant and integral features to ensure tax relief is maximised, so do please contact us if this affects you.

Qualifying activities

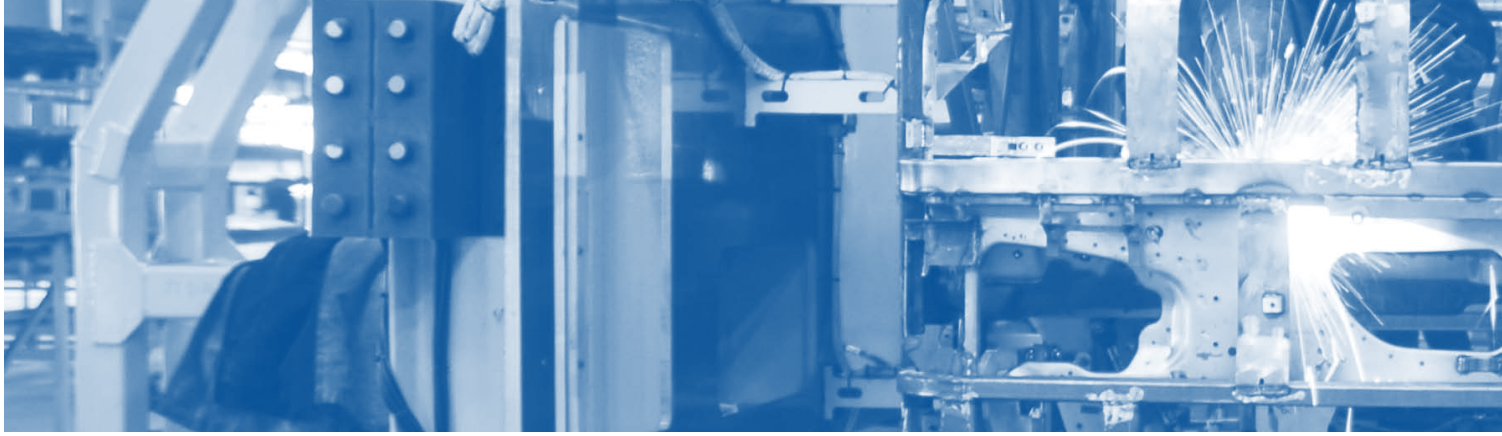
To claim capital allowances a person, whether company or individual, must have acquired the assets for a qualifying activity.

Key qualifying activities are:

- Trades, vocations and professions
- A property letting business (not the letting of dwellings)
- The letting of Furnished Holiday Accommodation (conditions must be met)
- Employment.

Changes to allowances

- The general 50% first year allowance (FYA) for small businesses and 40% FYA for medium sized businesses ceased to be available for expenditure incurred on plant and machinery from 6 April 2008 for the self employed or 1 April 2008 for companies.
- A new Annual Investment Allowance (AIA) has been introduced - see detail overleaf.
- A new temporary 12 month FYA for all businesses has been announced in Budget 2009 - see detail overleaf.
- A 100% enhanced capital allowance (ECA) continues to be available for expenditure on energy saving plant and machinery which includes certain 'green' cars.
- The annual allowance on the normal plant and machinery pool has reduced from 25% to 20%.
- The annual allowance on the new special rate pool is 10%.



What is the AIA?

The AIA applies to expenditure incurred on plant and machinery on or after 6 April 2008 for the self employed or 1 April 2008 for companies. It is not available for expenditure on cars but is available for most types of plant and machinery, including the new category, integral features.

The annual allowance is £50,000 per 12 month accounting period and all qualifying expenditure up to that level qualifies for a year to 100% allowance. Anything over that falls into the normal capital allowance pools at either 20% or 10%.

An apportionment of the £50,000 limit will be required if the accounting period straddles April 2008. For example, a company with a year to 31 December 2008 will only be entitled to an AIA of £37,500 ($9/12 \times £50,000$).

Am I a winner or a loser?

This depends on how much you spend and what you spend it on. For example, if you spend £10,000 per annum on plant, then you will be a winner. Previously, a small business would have obtained a 50% FYA (£5,000) but then would have had to write the balance off on a reducing balance at 25% (now 20%) per annum in future years. With the AIA, all of the £10,000 will be fully written off in year one so many small businesses will now get 100% up front relief on plant expenditure.

However, if you spend £200,000 on air conditioning, you will be a loser. Previously, a medium sized business would have received a 40% FYA (£80,000) and then a 25% reducing balance allowance per annum in future years.

Under the new rules, the AIA will only amount to £50,000. The balance of £150,000 expenditure will be allocated to the special rate pool and will obtain a 10% allowance in the same period. This would give total capital allowances for the year of expenditure of £65,000, being £50,000 AIA plus £15,000 annual allowance. In future periods only the 10% annual allowance will be available.

Comment

The timing of capital expenditure has always been an important consideration because of the effect on taxable business profits. These changes could mean that there is a significant impact. For the small business big swings in taxable profits could occur from one year to the next depending on the level of capital expenditure.

You may wish to discuss your expenditure plans so that together we can maximise the benefits available and also advise you of the cash flow implications for tax payments.

If you are self employed, you may also need to consider the impact of any resulting profit changes on your eligibility for tax credits.

Is AIA available to all businesses?

AIA is available to all sizes of business whether you operate as a company, sole trader or partnership. However, a mixed partnership, being a partnership not comprising only of individuals, is excluded.

- A company is entitled to a single AIA for all its qualifying activities.
- A sole trader or a partnership has the potential to have a separate AIA for each qualifying activity that is carried on. This applies even if an individual has several businesses or is involved in several partnerships.

For example, if N and D are in partnership and run a catering business with premises in Coventry and N also operates a childcare nursery in Leicester, each business would be entitled to the AIA. But if both qualifying activities were undertaken by a single company, they would have to share one AIA allowance.

The AIA will also have to be shared in what are known as 'related' business situations. The detailed rules are not considered here but simple examples of those affected include:

- a group of companies
- businesses with similar activities controlled by the same person
- businesses which operate from shared premises and which are controlled by the same person.

Comment

These rules are aimed at ensuring that businesses are not artificially structured simply to obtain more than one AIA entitlement such as splitting one trade between two companies. However, there will be a number of genuine businesses and independent companies which are caught by the rules so if you are involved in multiple business activities, you should consider obtaining advice on this issue so that your AIA entitlement can be established.

Temporary First Year Allowances (FYA)

Included within the 2009 Budget announcements was a statement that the Finance Bill 2009 will introduce a new temporary 40 percent first year allowance (FYA) for expenditure on plant and machinery.

The budget notes state that the temporary FYA will be available to:

- any individual;
- any partnership; and
- any company

where a qualifying activity is carried on in the 12 month period commencing 1 April 2009 for companies and 6 April 2009 for individuals and partnerships.

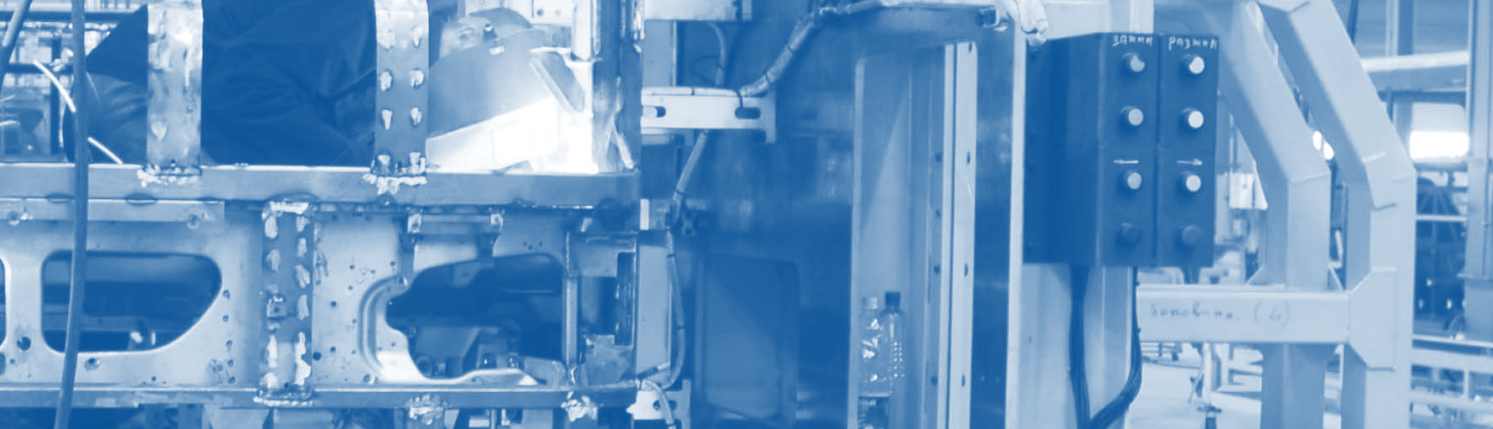
This is to give an extra boost of tax relief for expenditure on qualifying plant and machinery not covered by the AIA as otherwise it would only be eligible for a 20% annual allowance. The FYA does not apply to expenditure on integral features, cars, long life assets and assets for leasing.

Comment

The availability of additional capital allowances will be attractive to larger or plant intensive businesses where the AIA is insufficient, particularly groups of companies where one AIA has to be shared between all companies.

Expenditure not covered by AIA or FYA

Where expenditure is not fully covered by other allowances such as AIA or FYA it will either attract the 20% annual allowance in the main pool or the 10% allowance in the special rate pool.



Small plant and machinery pools

Businesses will be able to claim a one off allowance of up to £1,000 in the case of both the plant and the special rate pool, once the unrelieved expenditure in either the main rate pool or the special rate pool is £1,000 or less. This is to get rid of the tedious situation in very small businesses where, for example, a main pool balance of £600 continues to be written off bit by bit each year by the annual allowance of 20%.

This measure only has operational effect for chargeable periods beginning on or after 1 April 2008 for businesses within the charge to corporation tax and on or after 6 April 2008 for businesses within the charge to income tax so is only now going to have an impact.

For example, if a self employed person prepares accounts to 31 May, the first relevant period to which this new facility could be applied is the year ended 31 May 2009.

Business cars

The Finance Bill 2009 includes changes to the basis of capital allowances for car purchases and the tax relief thereon from 1 April 2009 for companies and 6 April 2009 for individuals in business.

For purchases before April 2009 the following rules apply:

- Cars with CO₂ emissions up to 110 grams per kilometre (g/km) qualified for the 100% ECA irrespective of cost.
- Cars costing up to £12,000 were included in the main plant pool and get the annual 20% reducing allowance only. The AIA cannot be applied against such purchases whereas it is available on vans.
- Cars costing more than £12,000 (so called expensive cars) usually had to be allocated to a separate single asset pool. Each qualifies for the annual allowance of 20% but with a maximum allowance on each car of £3,000. On disposal of each separate asset an extra allowance is available on any overall net cost.
- Qualifying hire cars such as short term hire cars, driving school cars or cars leased to the disabled - irrespective of cost – were included in the main pool and get a 20% allowance only. This applied even where the cars cost more than £12,000.
- Any cars used by the self employed with part non business use were also separately allocated to a single asset pool so that any private use element can be restricted. This does not apply to employee provided cars.
- Motor cycles were included within the definition of car for capital allowance and lease deduction purposes.

For purchases from April 2009:

The annual allowance is dependent on the CO₂ emissions of the car rather than the cost.

- Cars with CO₂ emissions up to 110 grams per kilometre (g/km) will continue to qualify for the 100% ECA irrespective of cost.
- Cars between 110 -160 g/km are placed in the main pool and will qualify for an annual allowance of 20%.
- Cars in excess of 160 g/km are placed in the special rate pool and will qualify for an annual allowance of 10%.

- The new rules apply to all cars including 'qualifying hire cars' which means they may not be as favourably treated as before.
- Any cars used by the self employed where there is part non-business use will still be separately allocated to a single asset pool. The annual allowance will initially be either 20% or 10% depending on the CO₂ emissions and then the allowance will be restricted for the private use element.

Motor cycles are now excluded from the definition of a car for capital allowance and lease deduction purposes. The tax treatment of motor cycles is considered in detail later in this briefing.

Comment

The proposals change the timings of when you will receive car allowances. There is a reduction of the annual allowances available on some business car purchases but on others there will be an initial advance on the allowances as there is no longer a £3,000 annual allowance limit on more expensive cars.

Example

A company purchases three cars for £20,000 in its 12 month accounting period to 31 December 2009. The dates of purchase and CO₂ emissions are as follows:

Red car	White car	Blue car
1 March 2009	1 May 2009	1 May 2009
145	145	165

Allowances in the year to 31 December 2009 relating to these purchases will be:

Red car (single pool as more than £12,000 cost)	White car (main pool as emissions less than 160)	Blue car (special rate pool as emissions more than 160)
£20,000 @ 20% = £4,000 but restricted to £3,000	£20,000 @ 20% = £4,000 No capping	£20,000 @ 10% = £2,000

In the following year to 31 December 2010 the allowances will be:

Red	White	Blue
£17,000 @ 20% = £3,400 but restricted to £3,000	£16,000 @ 20% = £3,200 No capping	£18,000 @ 10% = £1,800

Disposals

Where there is a disposal of plant and machinery from the main or special rate pools any balance of expenditure, after taking into account sale proceeds, continues to attract the annual allowance.

Where there is a disposal of a car held in a single asset pool, there is an additional allowance if there is an unrelieved cost often referred to as a balancing allowance.

This applies to:

- cars which cost greater than £12,000 prior to April 2009
- any cars used by the self employed with part non business use whenever purchased.

In the less usual situation of a car disposal where all costs have been recovered and there is an excess of sale proceeds then this is clawed back as a 'negative' capital allowance.

Comment

The key change here is that certain employee or director provided cars would have been placed in a single asset pool when the cost of the purchase exceeded £12,000. Therefore on disposal any shortfall in allowances would have been available at the time of disposal. For cars purchased from April 2009 this will not apply as the cars will be included in one of the two plant pools (main or special rate). Instead the annual allowance will continue to be claimed in that and subsequent periods.

Example

The company above sells all three cars in its accounting period to 31 December 2012 for £7,000. The tax balances immediately prior to sale and the effects of the sales are as follows:

At the start of the period	Red (single asset)	White (main pool)	Blue (special rate pool)
Tax balance	£11,200	£10,240	£14,580
Proceeds	(£7,000)	(£7,000)	(£7,000)
Balance after disposal	£4,200	£3,240	£7,580
Allowance permitted in period of disposal	£4,200	£648 (£3,240 @ 20%)	£758 (£7,580 @ 10%)
In subsequent periods	Nil as all covered	20% annually on the balance	10% annually on the balance

What if vehicles are leased or hired?

The first fact to establish with a leased vehicle is whether the lease is really a rental agreement or whether it is a type of purchase agreement, usually referred to as a finance lease. This is because there is a distinction between the accounting and tax treatment of different types of leases.

Tax treatment of rental type leases

The lease payments on operating leases are treated like rent and are deductible against profits. For finance leases, the allowable deduction is generally the same as accounts depreciation, together with any financing cost. However, whenever the lease relates to a car there may be a portion disallowed for tax.

For 2009/10 onwards, that is 1 April 2009 for companies and 6 April 2009 for individuals, a disallowance of 15% of the costs incurred is proposed for cars with CO₂ emissions which exceed 160 g/km. This will generally apply for all leases which commence after the relevant dates above.

For leases which commenced before the changeover date, the restriction is calculated according to a formula and applies to cars, except qualifying hire cars, which have a retail price when new in excess of £12,000. This restriction method will continue until the termination of the lease.

Example

Existing contracts

A car has a retail price of £20,000 and an annual lease charge of £6,000. There would be a disallowance of £1,200 using the statutory formula so only £4,800 would be tax deductible.

New contract from April 2009

For a car with a £6,000 annual lease charge on a 166 CO₂ emission car, the disallowed portion would be £900, so £5,100 would be deductible. If instead the car was a 157 CO₂ emission car, there would be no disallowance.

Exceptions under the new rules

No disallowance occurs in certain circumstances. Two key situations are where a business leases a car which:

- is classified as a low emissions car (up to 110 CO₂); or
- meets the condition of a qualifying short term hire.

Short term hire means for a period or periods not exceeding 45 days in total.

Some additional exceptions exist but are not considered further here.

Magnificent motorcycles

Motorcycles are to be excluded from the definition of cars from April 2009. This means that they will qualify as main pool plant and machinery and will be eligible for consideration for the following allowances:

- the 100% AIA
- the temporary FYA of 40%
- a 20% allowance where neither of the above apply.

Where there is part non business use of the asset by a self employed person, it will have to be placed in a single asset pool and a restriction on any allowances will be made for private use.

Summary of the changes to buildings

For many businesses there is no tax relief for expenditure on the premises from which they operate. The main buildings allowances available are Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs).

These are in the process of being phased out and will cease to apply by April 2011.

The annual allowance on industrial buildings (including hotels) and agricultural buildings will be based on a fixed percentage of the allowable amount in 2007/08 as indicated below.

Example

Year	Percentage	Example
2008/09	75%	Company X had an entitlement of £72,000 IBA in the year to 31 March 2008. This will now be £36,000 (50% of £72,000) for the year to 31 March 2010.
2009/10	50%	
2010/11	25%	
2011/12	0%	

On a disposal of such buildings there are generally neither any further allowances nor a claw back of allowances previously granted.

So what do I do now?

These changes are fundamental to many businesses. Please get in touch with us as soon as possible to discuss how we can maximise any allowances for your business.