

## Capital Allowances

The rules for Capital Allowances (CAs), like most tax issues, are complex, and should be checked carefully when planning business expenditure and completing tax returns. Here we briefly identify the main rules which will affect the small business. Please email us if you have further questions. These rules changed substantially in April 2008, and there were further changes in April 2009, especially for the rules relating to cars.

There is no obligation to claim CAs in any particular year. If no claim is made, the value for CAs is simply carried forward unchanged. Alternatively, a part claim can be made. This may be useful if a small profit is made, and the trader's personal allowance would be wasted if CAs were claimed.

Example:

Profits before CAs	£8,000
CAs available	<u>(£3,000)</u>
Taxable profit after CAs	£5,000

This is less than the Personal Allowance (PA), which is £6,475. It is therefore better to claim only £1,525, and claim further CAs in future years.

### **Tax planning point**

Capital Allowances are flexible, and can be used in full or in part, or not at all, in any particular year. If profits are low, it may be worth ignoring CAs in order to preserve the Personal Allowance.

### *Annual Investment Allowance (AIA)*

An AIA of £50,000 is available for most Plant and Machinery (P&M) except cars. This means that the full cost of new equipment can be offset against tax, up to £50,000 in each year. The allowance is reduced pro-rata for periods of less than 12 months.

### **Tax planning point**

Equipment bought on the last day of the trading period will qualify for 100% AIA in that year; if the purchase is delayed for one day, the AIA will not be available until one year later.

### *The Main Pool*

Most expenditure on which the AIA is not claimed goes into the Main Pool. An amount of 20% of this Pool can be claimed each year, the residue being carried forward to the following year. The value of the Pool at any time is known as the “written down value” (WDV). The amount deducted from the Pool and claimed for tax in a year is the “writing down allowance” (WDA).

Example:

Pool written down value b/fwd:	£5,000
Additions during year	£2,000
Disposals during year (sale price)	<u>(£1,000)</u>
Total	£6,000
WDA @20%	<u>(£1,200)</u>
WDV c/fwd	£4,800

Pools of value £1,000 or less can be written off in full. It is therefore desirable to reduce the Pool value to this value. However, the effect of the 20% WDA is that the Pool value decreases only slowly. Where possible therefore, it is desirable to keep new assets out of the Pool.

One way of doing this is to classify new assets as “short life”.

### *Short Life Assets*

It has for a long time been possible to treat some assets as “short life assets”. Typically, this would have used for items such as computers, which are likely to be written off within a relatively short period. Instead of the asset joining the main Pool, and being merged with assets which are written down slowly, the asset is treated separately as a Short Life Asset, and a balancing allowance is claimed when the asset is sold. (A balancing allowance is a CA for the unclaimed value of an asset. It will not arise on assets within the Pool, which are merged with other assets.)

Example:

A computer value £2,000 is purchased in 2008-9 and sold in 2010-11 for £200.

2008-9

Addition	£2,000
WDA 20%	<u>£400</u>
WDV c/fwd	£1,600

2009-10

WDA 20%	<u>£320</u>
WDV c/fwd	£1,280

2010-11

Disposal proceeds £200

Balancing allowance claimed £1,080

The effect is to accelerate the CA claim. It means that the business has obtained tax relief for the full cost of owning the asset (£2,000 - £200), by claiming £400 + £320 + £1,280.

If the computer had entered the Main Pool, the WDA in 2010-11 would have been only £256 (20% of £1,280), and an ever diminishing claim would have continued in future years. (Of course, in many cases the AIA would be used to claim the full amount in 2008-9; however, short life treatment would be useful if the AIA had not been claimed, for instance if profits that year had been low).

### **Tax planning point**

If the AIA is not used, it may be worth making a Short Life Asset election to accelerate CAs.

A final point on short life assets; the rules do not insist that only assets of a short expected life, such as computers, are so classified. If the asset has not been sold within 4 years, it reverts to the Main Pool.

### *Private Use Assets*

Certain assets do not join the Main Pool. These are assets which have private use, on which separate calculations are made, so that the trader is

charged for the private use. Suppose a computer value £1,000 is purchased, which is used 20% privately. The AIA or WDA is calculated, but is then reduced by the extent of the private use.

### Cars

Cars are treated for CAs according to their CO<sup>2</sup> emissions.

- Emissions less than or equal to 110 g/km – first year allowance of 100%
- Emissions between 111 – 160 g/km – WDA of 20%
- Emissions more than 160 g/km – WDA of 10%

Note that the FYA of 100% only applies to **new, unused** cars, and is subject to a deduction for private use.

Example:

New car of CO <sup>2</sup> 105 g/km, cost	£10,000
FYA 100%	£10,000
Private use 20%	<u>(£ 2,000)</u>
Total CA claim	£ 8,000

Private use does not apply to companies which buy cars. Instead, there is a benefit in kind charge on the employee.

#### **Tax planning point**

New cars, with CO<sup>2</sup> emissions of no more than 110 g/km, receive an FYA of 100%. In other words, such a car is fully deductible for tax in the year of purchase, subject to any private use deduction.

The HMRC leaflet IR 222 *How to Calculate your Taxable Profits* explains the rules further, with examples. Remember however that this link relates to the rules for tax year 2008-9, and cannot be relied on when planning for 2009-10. <http://www.hmrc.gov.uk/helpsheets/hs222.pdf>