



19 June 2008

Capital allowances – new rules

From 6 April 2008 (1 April 2008 for companies), the system of UK capital allowances has changed.

The new rules apply to expenditure incurred on or after these dates.

Capital allowances are now available for the following expenditure:

- plant and machinery - 20% writing down allowance;
- annual investment allowance – 100% relief for the first £50,000 of capital expenditure (not cars);
- enhanced capital allowance – 100% relief for capital expenditure on certain 'green' assets;
- integral features - 10% writing down allowance; and
- long life assets - 10% writing down allowance.

Capital allowances are also available for the acquisition of cars but this regime is due to change to being based on CO₂ emissions from April 2009.

Annual Investment Allowance ("AIA")

If a business incurs up to £50,000 of capital expenditure in a 12 month accounting period it can claim an immediate deduction for tax purposes.

This limit is increased/decreased in line with the length of the accounting period.

This is not available for cars but is available for the acquisition of long life assets or integral features.

If the claimant company is in a group or under common control with other companies the £50,000 limit is split among the companies (although the taxpayer can decide how it is split).

This restriction also applies where more than one unincorporated business is under common control but not if a company and an unincorporated business are controlled by the same person (e.g. a company and an LLP).

In addition if a partnership has a corporate partner the partnership will not be eligible to claim the AIA.

Enhanced Capital Allowances ("ECA")

Where a business incurs capital expenditure on assets that are 'green' it can claim an immediate tax write off.

Such assets are those incurred on energy-saving and environmentally-friendly expenditure and include certain air conditioning, combined heat and power, solar technology and water saving devices etc. A list of qualifying assets can be found at www.eca.gov.uk – this list changes as new technologies are identified.

AIA and ECA

A business may claim AIA and ECA. Businesses should therefore ensure that they identify any ECA expenditure separately from that qualifying for AIA.

E.g. if the business incurs £60,000 of capital expenditure it will be able to claim tax relief on £52,000 in year one (£50,000 AIA plus 20% of £10,000). However if the business reviews the expenditure and finds that £10,000 qualifies for ECA it will be able to claim tax relief on £60,000.

Businesses should therefore review their refurbishment and other capital expenditure and ensure that they maximise their claim for ECAs.

Payable ECA

From 1 April 2008 loss-making companies that incur expenditure on assets qualifying for ECA can claim a tax repayment.

The repayment is based on the lower of the loss for the year and the cost of the asset for which 100% tax relief was claimed.

The company can claim a tax repayment of 19% of the loss surrendered.



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Integral features

This is a new category of capital allowances and provides a writing down allowance of 10% on a reducing balance basis.

The categories of assets which are treated as integral features are:

- electrical systems (including lighting systems);
- cold water systems;
- space or water heating systems;
- a lift, escalator or a moving walkway; and
- external solar shading.

The space of water heating system also includes a powered system of ventilation, air cooling or air purification and any floor or ceiling comprised in such a system.

Good news is that this list does include items that were previously not normally eligible for capital allowances: electrical and cold water systems.

However of particular note is that some of these items, such as the air conditioning system and lift would normally have qualified for more accelerated capital allowances under the old regime.

Integral features are eligible for the AIA. Where such features contain 'green' expenditure they may qualify for accelerated capital allowances under the ECA scheme.

Businesses can therefore benefit from undertaking careful planning of expenditure to ensure that they maximise the availability of these accelerated allowances.

Refurbishments

When undertaking refurbishment work the advice has always been to categorise the expenditure between:

- revenue expenditure (repairs etc);
- capital expenditure qualifying for capital allowances; and
- other capital expenditure.

Although this advice has not changed care needs to be taken with regard to the repair of assets that are integral features because there are new provisions that mean that in certain cases they will be treated as a replacement rather than a repair.

The significance is that a repair should be fully deductible for tax purposes in the year of expense, whereas the replacement of the integral feature may only be eligible for a 10% writing down allowance.

The 'repair' will be treated as a replacement where the expenditure is more than 50% of the cost of replacing the integral feature when the expense is incurred. Otherwise the aggregate amounts incurred on the integral feature within 12 months from the date that the repair work commences, exceeds 50% of the replacement cost.

Actions

Careful planning should be undertaken to ensure maximum relief is obtained for capital expenditure:

- separately identify revenue and capital expenditure;
- ensure that revenue expenditure on integral features does not exceed 50% of the replacement cost;
- maximise the acquisition of ECA qualifying assets – visit the website for more information;
- as a company consider whether to claim the ECA tax repayment (or to offset the loss against profits in the same or a different accounting period); and
- claim AIA against assets qualifying for a lower rate of writing down allowance – i.e. integral features first.

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