

Chapter 5

CAPITAL ALLOWANCES

1 Capital allowances

- 1.1** Capital Allowances replace the disallowed depreciation charge in the adjustment of profits, giving tax relief against trading profits in respect of expenditure incurred on the cost of qualifying plant and machinery and (see later in this chapter) a newly introduced Structures and Buildings Allowance (SBA) on the qualifying cost of a qualifying commercial building.

Plant is generally defined as assets that perform an active function in the business – something with which the trade is carried on and will include office furniture and equipment including moveable office partitioning. Machinery will include motor vehicles and computers, including building alterations necessary for the installation of plant and machinery.

Plant and machinery capital allowances are not available on the cost of a building but are available on integral features of a building used in the trade including lifts and escalators, electrical systems, heating and air cooling systems

- 1.2** If a business is VAT registered and the input VAT is recoverable on the purchase of an asset then the VAT exclusive net cost will be available for capital allowances. If the VAT is not recoverable as for example on the purchase of a car or if the business is not VAT registered then the VAT inclusive price will attract capital allowances.

2 Capital Allowance Computations for Plant & Machinery

- 2.1** Capital allowance computations will be prepared for the accounting period of the business not the tax year and will be deducted from the adjusted trading profit of that accounting period.

- 2.2** **There are 3 types of capital allowance available on the qualifying cost of qualifying plant and machinery.**

(a) Annual Investment Allowance (AIA)

The AIA gives an allowance of 100% for the first £1,000,000 of qualifying expenditure incurred in a 12 month accounting period.

If the accounting period of the business is other than 12 months then the AIA will be time apportioned accordingly, for example a business that has prepared its accounts for a 9 month period would be entitled to AIA of £750,000 ($9/12 \times 1,000,000$). The date within the accounting period that the asset was purchased does not impact on the available AIA - it is only the length of the accounting period itself that may require the AIA limit of £1m to be time apportioned.

The £1m limit applies in the TX-UK exam regardless of the dates of the 12 month period covered by the exam question

AIA is available on the purchase of all plant and machinery **except** motor cars.

Any expenditure in excess of the AIA limit or on the majority of motor cars will qualify instead for an annual writing down allowance (WDA).

(b) Writing Down Allowance (WDA)

The cost of most plant and machinery that has not qualified for AIA will be allocated to a pool of expenditure that will then be eligible for an annual WDA of either 18% per annum if expenditure qualifies for the main pool, or 6% per annum if allocated to the special rate pool, available on a reducing balance basis. See later notes on which expenditure on plant and machinery is allocated to the main pool (majority!) and which other expenditure is allocated to the special rate pool.

With the exception of new electric motor cars with zero CO₂ emissions which attract a 100% First Year Allowance (FYA) (see below), motor cars will qualify for a WDA of either 18% per annum if CO₂ emissions are between 1 and 50 grams per kilometre and be allocated to the main pool, or 6% per annum if CO₂ emissions exceed 50 grams per kilometre which will then be allocated to the special rate pool. Remember that cars do not qualify for AIA.

As with AIA the WDA will be time apportioned where the accounting period is other than 12 months.

(c) First Year Allowance (FYA)

New electric cars with zero CO₂ emissions attract a 100% FYA. The FYA is never time apportioned.

ILLUSTRATION 1

Richard commenced to trade on 1 January 2021 and prepared accounts to 31 March 2021 and to 31 March thereafter. Richard made the following acquisitions of main pool assets:

Accounting Period to 31 March 2021

		£
1 January 2021	Plant	220,000
20 January 2021	Computer equipment	80,000

Accounting Year ended 31 March 2022

19 May 2021	Machinery	30,000
-------------	-----------	--------

Capital Allowance Computations**3 month period to 31 March 2021**

			<i>Main Pool</i>	<i>Allowances</i>
Additions (AIA)				
1 January 2021	Plant	220,000		
20 January 2021	Computers	80,000		
		<u>300,000</u>		
AIA (max 3/12 x 1,000,000)		(250,000)	50,000	250,000
WDA (max 3/12 x 18% x 50,000)			(2,250)	2,250
Total Allowances				<u>252,250</u>
Tax Written Down Value (TWDV) c/f			<u>47,750</u>	

Year Ended 31 March 2022

TWDV b/f			47,750	
Additions (AIA)				
19 May 2021		30,000		
AIA		(30,000)		30,000
WDA (18%)			(8,595)	8,595
Total Allowances				<u>38,595</u>
TWDV c/f			<u>39,155</u>	

3 Capital Allowance Rates

The capital allowances information that will be given in the tax rates and allowances section of the examination papers for the June 2022 exam through to the March 2023 exam sitting is as follows:

Rates of allowance	%
Plant and machinery	
Main pool	18
Special Rate Pool	6

Motor Cars

New electric cars with zero CO ₂ emissions	100
CO ₂ emissions between 1 and 50 grams per Km	18
CO ₂ emissions over 50 grams per Km	6

Annual Investment Allowance

Rate of allowance	100
Expenditure limit	£1,000,000

As can be seen from this information it is therefore essential for students to know what type of allowances are available for each asset acquired during the accounting period of the business:

- As stated in section 3 above new electric cars with zero CO₂ emissions qualify for a 100% FYA.
- As stated in section 2 above all plant and machinery with the exception of cars will qualify for AIA with any excess expenditure over £1,000,000 per annum and cars then qualifying for WDA at either 18% per annum if qualifying for the main pool or 6% per annum if allocated to the special rate pool.

If expenditure qualifying for AIA exceeds the AIA limit, the AIA should be allocated firstly to special rate expenditure before main pool expenditure, as any excess expenditure will then only attract 6% WDA in the special rate pool, whereas 18% is available in the main pool. It is therefore necessary to know what expenditure is excluded from the main pool and allocated instead to the special rate pool.

4 Special Rate Pool

The following asset acquisitions should be allocated to the special rate pool:

- (1) Integral features of a building
 - » Lifts and escalators
 - » Electrical and general lighting systems
 - » Cold water systems
 - » Space or water heating systems
 - » Systems of ventilation, air cooling or purification
- (2) Long life assets

Assets, when new, with an expected economic working life of 25 years or more when total expenditure, based on a 12 month accounting period, exceeds £100,000

- (3) Thermal insulation of a building, and
- (4) Motor cars with CO₂ emissions over 50 grams per km

Note however that this expenditure being on cars does NOT qualify for AIA and only the 6% WDA is available.

ILLUSTRATION 2

Steven prepares accounts to 31 March

The WDV of the main pool at 1 April 2021 is £40,000. The following transactions took place during the year ended 31 March 2022:

4 May 2021	Purchased plant for £50,000
30 June 2021	Purchased a motor car for £11,200 with CO ₂ emissions of 40g/km
6 July 2021	Purchased a motor car for £14,100 with CO ₂ emissions of 70g/km
15 March 2022	Purchased a new electric motor car with zero CO ₂ emissions for £14,400

Calculate the capital allowances for the year ended 31 March 2022.

Accounting period to 31 March 2022

	<i>Main Pool</i>	<i>Special Rate Pool</i>	<i>Allowances</i>
	£	£	£
WDV b/f	40,000		
Additions qualifying for AIA			
Plant	50,000		
AIA	(50,000)		50,000
Other additions			
Motor car (40g/km)	11,200		
Motor car (70 g/km)		14,100	
	51,200	14,100	
WDA @ 18%	(9,216)		9,216
WDA @ 6%		(846)	846
Additions qualifying for 100% FYA			
Motor car (zero g/km)	14,400		
FYA @ 100%	(14,400)		14,400
			74,462
WDV c/f	41,984	13,254	

ILLUSTRATION 3

Kenny prepares accounts to 31 December. At 1 January 2021 the WDV brought forward on the main pool was £22,000.

The following transactions occurred in the year ended 31 December 2021.

22 July 2021	Purchased machinery	£45,000
13 November 2021	Purchased a long life asset	£1,030,000
25 November 2021	Purchased a motor car CO ₂ emissions of 45g/km	£8,000

Calculate Kenny's capital allowances for year ended 31 December 2021

Accounting period to 31 December 2021

	<i>£'000</i>	<i>£</i>	<i>Main Pool</i>	<i>Special Rate Pool</i>	<i>Allowances</i>
WDV b/f		22,000			
Additions qualifying for AIA					
Long life asset	1,030				
AIA (Maximum)	(1,000)				1,000,000
				30,000	
Additions qualifying for AIA					
Machinery	45				
AIA	(-)				
Other additions				45,000	
Motor car (emissions 45g/km)		8,000			
		75,000		30,000	
WDA @ 18%		(13,500)			13,500
WDA @ 6%				(1,800)	1,800
					1,015,300
WDV c/f		61,500		28,200	

5 Sale of plant and machinery

When plant and machinery is sold in the accounting period the sale proceeds, up to a maximum of the original cost of the asset, is deducted from the balance of the unrelieved expenditure of the relevant pool before computing the WDA of the accounting period in the normal way. It is important to understand that the WDA computations will continue through to the cessation of trading of the business even if all the items of plant and machinery had been sold by the business. The business would still be able to continue trading in these circumstances as it may for example have decided to rent the required plant and machinery rather than purchase.

The Small Pools WDA

Where the tax wdv of either the main pool or special rate pool prior to calculating the WDA is less than £1,000, the entire balance may be taken as a WDA in that period. The £1,000 is prorated if the accounting period is other than 12 months.

EXAMPLE 1

Beth prepares accounts to 5 April. The WDV as at 6 April 2021 of her main pool is £1,250. She purchases machinery for £10,000 in the year and sells an item of plant for £500 (cost £3,000).

Calculate her capital allowances for the year ended 5 April 2022

6 Non Pool Assets

In the following circumstances assets will not go to either the main or special rate pools but will instead have their own separate column on the capital allowance computation:

- (1) Assets with private use by the business owner, or
- (2) Short life assets on which the taxpayer has made a depooling election.

6.1 Private use of an asset by the owner of the business

Where an asset is used by the **owner** of the business (this can be either a sole trader or a partner in a partnership) partly for business and partly for private purposes (typically a motor car), only the business proportion of the available capital allowances is given. This proportion is computed by reference to the percentage of business use to total use. The following rules must be followed when computing capital allowances:

- (a) The cost is not brought into the main or special rate pool, but must be the subject of a separate column on the computation
- (b) The WDA (or AIA or FYA) of the asset is calculated on its full cost but only the business proportion of any allowance is actually given.
- (c) On disposal of the asset, a balancing adjustment is computed by deducting sale proceeds from the tax wdv (there is a balancing charge if sale proceeds exceed tax wdv, and a balancing allowance if sale proceeds are less than tax wdv). Having computed the balancing adjustment, the amount assessed or allowed is then reduced to the business proportion. A balancing allowance is then added in to the capital allowances of the period whereas a balancing charge will reduce the capital allowances. If a balancing charge exceeds the allowances available then the net balancing charge is added to the adjusted trading profit of the period
- (d) Private use by an employee of an asset owned by the business (again typically a car) has no effect on the business's entitlement to capital allowances. This is why the private use of an asset is irrelevant for companies, as directors are treated as employees for this purpose. Instead, there will normally be an employment income assessment as a benefit charge on the employee or director (see chapter 9).

EXAMPLE 2

Jane prepares accounts to 31 December. At 1 January 2021 the tax WDV's brought forward are as follows:

	£
Main Pool	21,200
Motor car (35g/km) (used 30% for private purposes by Jane)	13,600

The following transactions took place during the year ended 31 December 2021:

10 May 2021	Purchased plant for £6,600
25 June 2021	Purchased a motor car for £10,600 CO ₂ emissions of 40g/km to be used by an employee who will use it 80% for business purposes
15 October 2021	Sold the motor car used privately by Jane for £9,400
16 October 2021	Purchased a motor car for £16,000 CO ₂ emissions of 80g/km (used 30% for private purposes by Jane)

Calculate Jane's capital allowances for the year ended 31 December 2021.

6.2 Short-life assets

- (a) An election can be made to omit short life assets from the main pool and include them in their own individual column. This is known as a "depooling" election.
- (b) This allows the acceleration of capital allowances on short-life plant and machinery where they are sold at a low residual value or scrapped within 8 years following the end of the accounting period in which it was acquired.
- (c) Any plant and machinery that would normally go to the main pool, **except cars**, can be treated as a short-life asset.
- (d) Capital allowances on each short-life asset are calculated separately
- (e) On disposal within 8 years of the end of the accounting period in which the acquisition took place a balancing allowance or charge arises, which would not occur if the item was pooled. Clearly the election would only be worthwhile if a balancing allowance was anticipated.
- (f) If no disposal takes place within 8 years of the end of the accounting period in which the acquisition took place the unrelieved balance is transferred to the pool.

The transfer is immediately after the 8th anniversary of the end of the accounting period in which it was acquired.

- (g) The AIA is available against expenditure on short life assets. If expenditure is outside this limit then expenditure on main pool items will qualify for a WDA of 18%.
- (h) The AIA could be matched with short life assets. However if total expenditure on plant and machinery is above £1,000,000 the AIA would be allocated to the main pool additions first, as no balancing allowance occurs on sale. If the AIA is allocated to main pool items first then a short life asset election could be made on any short-life assets, with balancing allowances crystallising on disposal.
- (i) Given the amount of AIA available at £1,000,000 pa, it is very unlikely that the election would now be worthwhile for most unincorporated traders. An exam question may still be set of course for an unincorporated trader selling a short life asset where the election had been made when AIA was previously at a much lower level. Example 3 below, however shows both the election being made and the resultant effect on the disposal of the asset.

EXAMPLE 3

John prepares accounts to 31 March in each year.

At 1 April 2021 the WDV of the main pool was £16,000.

On 1 July 2021 John purchased machinery for £1,020,000

On 1 September 2021 John purchased a photocopier for £40,000 and made a short life asset election.

On 1 July 2022 the photocopier was sold for £15,000.

Calculate the capital allowances for years ended 31 March 2022 and 2023

6.3 Balancing adjustments on the Main or Special Rate Pools

- (a) A balancing charge can arise at any time on the main pool or special rate pool if disposal proceeds exceed the balance on the pool. If a net balancing charge arises on the capital allowances computation this would be added to the adjusted trading profit of the accounting period.

EXAMPLE 4

Peter prepares accounts to 31 December. In the year ended 31 December 2021 the following transactions took place:

10 April 2021 Plant sold (originally purchased for £10,200) for £8,600

1 October 2021 Second hand motor car (emissions 45g/km) purchased for £2,000

The WDV on the main pool as at 1 January 2021 was £4,000.

Calculate the balancing adjustment for the year ended 31 December 2021

- (b) A Balancing allowance can only occur on the main pool and special rate pool on cessation of the trade
(c) No AIA, WDA or FYA are available in the final accounting period of the business

EXAMPLE 5

Kris prepares accounts to 31 December.

Kris ceased to trade on 31 March 2022 on which date all plant and machinery was sold for £5,000.

The WDV on the main pool as at 1 January 2022 was £12,000.

Machinery was purchased on 1 February 2022 for £4,000

Calculate the balancing adjustment for the accounting period ended 31 March 2022

7 Preparing the Capital Allowance Computation

It is essential to follow a set format in dealing with the additions and disposals of assets in the accounting period in the preparation of the capital allowance computation for plant and machinery:

- (1) List any tax written down values (unrelieved expenditure) on the pools and any non-pool assets at the start of the accounting period as given within the question.
- (2) List expenditure qualifying for AIA, in order, firstly special rate pool and then main pool
- (3) Add any expenditure in excess of the AIA limit to the relevant pool
- (4) Add to relevant pool (main or special rate) the cost of any cars qualifying for WDA ie cars with CO₂ emissions
- (5) Deduct sale proceeds, to a maximum of original cost, of assets sold during the accounting period from the relevant pool balance
- (6) Deduct sale proceeds, to a maximum of original cost from the tax WDV of any non-pool assets and compute the relevant balancing adjustment
- (7) Compute available WDA's on the Tax WDV's computed and deduct therefrom
- (8) List any new electric zero emission cars purchased during the accounting period and claim the available 100% FYA

8 Full Pro forma Capital Allowances Computation

		<i>Main pool</i>	<i>Special Rate Pool</i>	<i>Short life asset (1)</i>	<i>(Business %) Private use Asset</i>	<i>Allowances</i>
	£	£	£	£	£	£
WDV b/f		X		X	X	
Additions qualifying for AIA						
- long life assets	X					
- integral features of a building	X					
- thermal insulation	X					
AIA (Note a)	(X)					X
Additions qualifying for AIA			X			
- machinery	X					
- plant	X					
AIA (Note a)	(X)					X
		X				
Other Additions						
Motor cars						
emissions 1-50g/km		X				
emissions >50 g/km			X			
Disposals		(X)		(X)		
		X	X	X	X	
(Note b)						
WDA × 18%		(X)				X
WDA × 18%/6%					(X)	X
					(× Business use)	
WDA × 6%			(X)			X
Balancing allowance				(X)		X
Additions qualifying for FYA						
Motor car zero emissions	X					
FYA @ 100%	(X)					X
Allowances for period						X
WDV c/fwd		X	X	-	X	

Notes

- (a) The AIA is allocated to assets included in the special rate pool in priority to those included in the main pool, though it is very unlikely that in an income tax question (dealing with an unincorporated trader) that the total expenditure qualifying for AIA will exceed the £1M annual limit.
- (b) If the balance on the main pool and /or special rate pool is ≤ £1,000 for a 12 month accounting period, the small pool WDA could be claimed

EXAMPLE 6 (COMPREHENSIVE)

Ling prepares accounts to 31 March. The WDV of the main pool at 1 April 2021 was £30,000, and on a car (90g/km) £14,000. The car was used by Ling 20% for private use.

The following transactions took place during the year ended 31 March 2022

6 May 2021	Purchased electric motor car (zero emissions)	£17,000
10 June 2021	Purchased computer equipment	£60,000
25 June 2021	Purchased a machine	£84,000
7 September 2021	Purchased plant	£60,000
10 November 2021	Purchased a motor car (emissions 40g/km)	£11,200
3 December 2021	Purchased thermal insulation for the business building	£28,000
9 December 2021	Disposed of the car used privately by Ling	£8,000

Calculate the capital allowances for year ended 31 March 2022 assuming that no short life asset election is to be made in respect of the computer equipment.

9 Structures & Buildings Allowance

A new Structures and Buildings capital allowance (SBA) has been introduced which will only be tested in our exam for building construction on or after 6 April 2020 for unincorporated traders and for companies on or after 1 April 2020.

An annual WDA will be available on the qualifying cost of a qualifying building at a rate of 3%.

Qualifying buildings will include factories, warehouses and offices along with both wholesale and retail properties and will further include the cost of walls, tunnels and bridges.

Any part of a building used as a dwelling house and the cost of any land will not qualify for SBA.

Where an unused building is bought from a developer the price paid – excluding the value of the land – will be eligible for the SBA from the time that the property is brought into a qualifying use, such as principally its use within a trade or letting, hence if a building is only brought into such use part way through an accounting period then the WDA must be time apportioned.

Expenditure which qualifies as plant and machinery cannot also have SBA.

ILLUSTRATION 1

A trader prepares accounts to 31 March in each year and on 31 October 2021 bought a new warehouse from the builder at a cost of £240,000 which included the land valued at £90,000. The warehouse was then used in the trade from 1 January 2022.

The qualifying expenditure is £150,000 (240,000 – 90,000) and the 3% SBA will be available from 1 January 2022 so that for the year ended 31 March 2022 a SBA of £1,125 (150,000 x 3% x 3/12) will be available. From the year ended 31 March 2023 a full SBA of £4,500 will be claimable.

On the sale of the building there is no balancing adjustment for the vendor but instead any allowances claimed will be added to the sale proceeds of the building in computing any chargeable gain or allowable loss arising on the sale.

The SBA will again be time apportioned in the accounting period of sale up to that date.

ILLUSTRATION 2

Assume that the trader in Illustration 1 continues to use the building in his trade until 30 September 2023 at which date the warehouse is sold for proceeds of £300,000 including £120,000 for the land.

The trader will have claimed the following amounts of SBA during his period of use of the property:

Year ended 31 March 2022 (as above)	£1,125
Year ended 31 March 2023 (as above)	£4,500
Year ended 31 March 2024 ($£4,500 \times 6/12$)	<u>£2,250</u>
Total allowances claimed	<u>£7,875</u>

Although chargeable gains are dealt with later in these Study Notes, the basic calculation of a chargeable gain is a simple one – deduct the allowable cost of an asset from its sale proceeds – but in this situation the sale proceeds of the property (including land) will be increased by the capital allowances claimed of £7,875. The chargeable gain on the sale would therefore be computed as:

Sale Proceeds ($300,000 + 7,875$)	£307,875
Less: Allowable cost	<u>(£240,000)</u>
Chargeable Gain	<u>£67,875</u>

The trader buying the property will simply continue the same 3% claim on the original cost of the building – in this example £4,500 in each accounting year. If the buyer prepared accounts to 30 June in each year and immediately brought the property into use on 1 October 2023, then it would have been purchased in the accounting year ended 30 June 2024 and for that period would have been used in the trade for a period of 9 months and would therefore give rise to a claim of £3,375 ($9/12 \times £4,500$).

From the year ended 30 June 2025 a full annual WDA of £4,500 would be claimed until all of the original qualifying cost had been claimed.

If renovation expenditure was incurred on a qualifying building from 6 April / 1 April 2020, it too will be eligible for SBA again from the date the building was brought back into use. This SBA claim would be entirely separate to any claim (if available) for the original cost of the building.

If a question states you are dealing with the **purchase** of a building, rather than the **construction** of a building then **no** SBA will be available unless the question explicitly states that it is able to be claimed.

You should now review the following part of the Finance Act 2021 technical article written by the TX-UK examining team - Capital Allowances section and work Example 16 on plant and machinery capital allowances and Examples 17 - 19 dealing with SBA

You may now attempt Practice Question 11