

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.

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.

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

It is important to understand that capital allowances are not available on all capital expenditure but ONLY on qualifying plant and machinery as stated above, for example as stated above the cost of a property purchased for use within the trade is capital expenditure but ONLY the cost of the integral features of that building will qualify for capital allowances

- 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

- 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 £200,000 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 £150,000 ($9/12 \times 200,000$). The £200,000 limit applies in the TX-UK exam regardless of the 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 a 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 a WDA of either 18% per annum if expenditure qualifies for the main pool, or 8% per annum if allocated to the special rate pool, available on a reducing balance basis. See later notes on which expenditure is allocated to the main pool (majority!) and which other expenditure is allocated to the special rate pool.

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

(c) First Year Allowance (FYA)

New cars with CO₂ emissions up to 50 grams per kilometre attract a 100% FYA. The FYA is never time apportioned.

ILLUSTRATION 1

Richard commenced to trade on 1 July 2017 and prepared accounts to 31 December 2017 and to 31 December thereafter. Richard made the following acquisitions of main pool assets:

Accounting Period to 31 December 2017

		£
1 July 2017	Plant	120,000
20 October 2017	Computer equipment	30,000

Accounting Year ended 31 December 2018

19 May 2018	Machinery	30,000
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Capital Allowance Computations**6 month period to 31 December 2017**

			Main Pool	Allowances
Additions (AIA)				
1 July 2017	Plant	120,000		
20 October 2017	Computers	30,000		
		150,000		
AIA (max 6/12 x 200,000)		(100,000)	50,000	100,000
WDA (max 6/12 x 18% x 50,000)			(4,500)	4,500
Total Allowances				104,500
Tax Written Down Value (TWDV) c/f			45,500	

Year Ended 31 December 2018

TWDV b/f			45,500	
Additions (AIA)				
19 May 2018		30,000		
AIA		(30,000)		30,000
WDA (18%)			(8,190)	8,190
Total Allowances				38,190
TWDV c/f			37,310	

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 2019 exam through to the March 2020 exam sitting is as follows:

Rates of allowance	%
Plant and machinery	
Main pool	18
Special Rate Pool	8

Motor Cars

New cars with CO ₂ emissions up to 50 grams per Km	100
CO ₂ emissions between 51 and 110 grams per Km	18
CO ₂ emissions over 110 grams per Km	8

Annual Investment Allowance

Rate of allowance	100
Expenditure limit	£200,000

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 cars with low 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 £200,000 per annum and cars then qualifying for WDA at either 18% per annum if qualifying for the main pool or 8% 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 only attract 8% 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 110 grams per km
- Note however that this expenditure being on cars does NOT qualify for AIA and only the 8% WDA is available.

ILLUSTRATION 2

Steven prepares accounts to 31 March

The WDV of the main pool at 1 April 2018 is £40,000. The following transactions took place during the year ended 31 March 2019:

4 May 2018	Purchased plant for £50,000
30 June 2018	Purchased a motor car for £11,200 CO ₂ of 100g/km
6 July 2018	Purchased a motor car for £14,100 CO ₂ of 170g/km
15 March 2019	Purchased a motor car for £14,400 CO ₂ of 45g/km

Calculate the capital allowances for the year ended 31 March 2019.

Accounting period to 31 March 2019

	<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 (100g/km)	11,200		
Motor car (170 g/km)		14,100	
	51,200	14,100	
WDA @ 18%	(9,216)		9,216
WDA @ 8%		(1,128)	1,128
Additions qualifying for 100% FYA			
Motor car (45g/km)	14,400		
FYA @ 100%	(14,400)		14,400
			74,744
WDV c/f	41,984	12,972	

ILLUSTRATION 3

Kenny prepares accounts to 31 December. At 1 January 2018 the WDV brought forward on the main pool was £22,000.

The following transactions occurred in the year ended 31 December 2018.

22 July 2018	Purchased machinery	£45,000
13 November 2018	Purchased a long life asset	£230,000
25 November 2018	Purchased a motor car CO ₂ emissions of 105g/km	£8,000

Calculate Kenny's capital allowances for year ended 31 December 2018

Accounting period to 31 December 2018

	<i>Main Pool</i>		<i>Special Rate Pool</i>	<i>Allowances</i>
	£	£	£	£
WDV b/f		22,000		
Additions qualifying for AIA				
Long life asset	230,000			
AIA (Maximum)	(200,000)			200,000
			30,000	
Additions qualifying for AIA				
Machinery	45,000			
AIA	(-)			
		45,000		
Other additions				
Motor car (emissions 105g/km)		8,000		
		75,000	30,000	
WDA @ 18%		(13,500)		13,500
WDA @ 8%			(2,400)	2,400
				215,900
WDV c/f		61,500	27,600	

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.

6 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 2018 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 2019

7 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.

7.1 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 2018 the tax WDV's brought forward are as follows:

	£
Main Pool	21,200
Motor car (105g/km) (used 30% for private purposes by Jane)	13,600

The following transactions took place during the year ended 31 December 2018:

10 May 2018	Purchased plant for £6,600
25 June 2018	Purchased a motor car for £10,600 CO ₂ emissions of 100g/km to be used by an employee who will use it 80% for business purposes
15 October 2018	Sold the motor car used privately by Jane for £9,400
16 October 2018	Purchased a motor car for £16,000 CO ₂ emissions of 180g/km (used 30% for private purposes by Jane)

Calculate Jane's capital allowances for the year ended 31 December 2018.

7.2 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 £200,000 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 £200,000 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 2018 the WDV of the main pool was £16,000.

On 1 July 2018 John purchased machinery for £220,000

On 1 September 2018 John purchased a photocopier for £4,000 and made a short life asset election.

On 1 July 2019 the photocopier was sold for £1,500.

Calculate the capital allowances for years ended 31 March 2019 and 2020

7.3 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 2018 the following transactions took place:

10 April 2018 Plant sold (originally purchased for £10,200) for £8,600

1 October 2018 Second hand motor car (emissions 95g/km) purchased for £2,000

The WDV on the main pool as at 1 January 2018 was £4,000.

Calculate the balancing adjustment for the year ended 31 December 2018

- (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 2019 on which date all plant and machinery was sold for £5,000.

The WDV on the main pool as at 1 January 2019 was £12,000.

Machinery was purchased on 1 February 2019 for £4,000

Calculate the balancing adjustment for the accounting period ended 31 March 2019

8 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:

- (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 in excess of 50 grams per Km
- (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 low emission cars purchased during the accounting period and claim the available 100% FYA

9 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 51-110g/km		X				
emissions >110 g/km			X			
Disposals		(X)		(X)		
		X	X	X	X	
(Note b)						
WDA × 18%		(X)				X
WDA × 18%/8%					(X)	X
					(× Business use)	
WDA × 8%			(X)			X
Balancing allowance				(X)		X
Additions qualifying for FYA						
Motor car emissions ≤ 50g/km	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,
- (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 2018 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 2019

6 May 2018	Purchased a motor car (emissions 40g/km)	£17,000
10 June 2018	Purchased computer equipment	£60,000
25 June 2018	Purchased a machine	£84,000
7 September 2018	Purchased plant	£60,000
10 November 2018	Purchased a motor car (emissions 85g/km)	£11,200
3 December 2018	Purchased thermal insulation for the business building	£28,000
9 December 2018	Disposed of the car used privately by Ling	£8,000

Calculate the capital allowances for year ended 31 March 2019 assuming that no short life asset election is to be made in respect of the computer equipment.

You should now review the following part of the Finance Act 2018 technical article written by the TX-UK examining team - Capital Allowances section and work Example 16

You may now attempt Practice Question 11