bostockwhite

chartered accountants and business advisers

Cabourn House Station Street Bingham Nottinghamshire NG13 8AQ

Tel:01949 838838 Fax:01949 831174

Email: tony@bostockwhite.com
or: samantha@bostockwhite.com

www.bostockwhite.com

Capital allowances

- Topical issues, opportunities and changes ahead

This briefing considers recent developments and announcements in the core area of plant and machinery capital allowances including the important forthcoming changes for 2012.

Opportunities for maximising relief and avoiding pitfalls are highlighted, including the critical issues of timing and identification of qualifying capital expenditure.

1 April 2011 welcomed in a reduction of corporation tax rates of at least one percent for all companies. However, to pay for the cost of that reduction, two key changes to capital allowance rates on plant and machinery are set to impact from April 2012. These changes affect not only companies but all qualifying businesses that claim capital allowances.

Changes to the Annual Investment Allowance (AIA)

The AIA provides 100% tax relief on most types of plant and machinery (not cars) including integral features for all forms of qualifying business.

Since April 2010 the maximum annual limit available has been £100,000 but this is to reduce to £25,000 for expenditure incurred on or after 1 April 2012 for companies and 6 April 2012 for the self-employed in business.

An apportionment of the limits is required if the accounting period straddles 1 or 6 April 2012. This will be the case for many businesses.

Example 1

Company P makes up its accounts to 30 September annually. For the year to 30 September 2012, the limit is calculated as £62,500 as follows:

1 October 2011 – 31 March 2012 6/12 x £100,000 = £50,000

1 April 2012 – 30 September 2012 6/12 x £25,000 = £12,500

However, a restriction is set so that, for expenditure incurred in the part of the accounting period falling on or after 1 or 6 April 2012, the maximum entitlement is given only by reference to the appropriate share of the £25,000 limit.

Using Company P in example 1 this would be £25,000 x 6/12 = £12,500.

Example 1 continued

Company P is planning on spending £60,000 on purchasing machinery. If this is done in the six months to 31 March 2012, the whole amount would qualify for AIA as it is within the overall limit for the company's accounting period. However, if instead that same purchase was made in the second six months to 30 September 2012, only £12,500 would qualify for AIA due to the cap which applies from 1 April 2012.

Comment

The timing of expenditure in an accounting period affected by this change could have an important impact on the tax relief available and hence the taxable profits of a business. We can help you plan what action would suit your business requirements in respect of this change taking into account both tax saving and cash flow issues.

Changes to Writing Down Allowances (WDAs)

Annual WDAs are available to relieve qualifying plant and machinery expenditure not relieved by other capital allowances such as AIA. There are two rates. A rate of 20% for plant and machinery generally. This includes cars up to and including 160 CO_2 emissions and a 10% rate for the special rate pool which applies to integral features, long life plant and cars in excess of 160 CO_2 emissions.

These WDA rates are to reduce from 1 April 2012 for companies and from 6 April 2012 for the self employed.

The annual rates will move from:

- 20% to 18% on expenditure allocated to the main plant pool and
- 10% to 8% on expenditure allocated to the special rate pool.

Hybrid rates apply for accounting periods which span 1 or 6 April 2012. The example below demonstrates the principle of how this operates but in practice this calculation has to be done on a strict daily basis.

Example 2

Company A has an accounting period of 12 months to 31 December 2012, the main pool rate is calculated as:

(3/12 x 20%) 5% + (9/12 x 18%) 13.5% = 18.5%.

The effect of these changes will mean that the period over which tax relief is obtained is longer than previously. In fact according to the Government - 'It is estimated that approximately 2 million businesses could see an increase in their tax liability as a direct result of this measure.' So, taking advantage of other opportunities, which may accelerate capital allowances and the corresponding tax relief, becomes more pertinent. One such way of obtaining more capital allowances earlier is to make a 'short life asset' election where this is available.

Short life assets (SLA)

An asset which qualifies to be treated as a SLA can be separately pooled. This means that it is isolated for tax relief purposes from the main plant pool. Initially it is eligible for the same allowances (AIA and WDA) as would have applied if placed in the main plant pool. However, on disposal, where there is unrelieved expenditure after taking disposal proceeds into account, an extra allowance can be claimed for the unrelieved amount. This equates to writing off the whole of the cost (less disposal proceeds) of the asset over the actual economic life of that asset to the business.

Example 3

A commercial vehicle is to be purchased for £45,000 on 1 September 2011. The accounting period is 12 months to 31 March 2012 but the company has already used up its full AIA entitlement for that accounting period. This means that only WDA is due and this will be calculated on the reducing balance of expenditure each period. The purchase qualifies for the main pool rate - that is initially at 20% and then at 18% from 1 April 2012. It is expected that this vehicle will be used in the business until 31 March 2016 when it will be scrapped.

The company will receive £25,151 WDA during the accounting periods of ownership and a further £3,573 WDA in the accounting period of disposal to 31 March 2016. However, there will still be unrelieved expenditure of £16,276 after the asset has been scrapped. This will continue to receive smaller annual amounts of WDA over subsequent years.

If instead a SLA election is made on the asset, an allowance of £19,849 could be claimed on disposal in 2016. The tax saving is worth £3,255 using the current 20% small company rate.

Comment

Many small (and possibly medium too!) businesses have not found it advantageous to make SLA elections on additions since April 2008 due to the availability of the AIA. Most small businesses have found that the AIA covered their additions in full, thus 100% tax relief was obtained in the year of acquisition. The AIA reduction from April 2012 makes the SLA election more attractive to a wider range of businesses.

A change which improves the relief!

The SLA facility has been available for many years but in the context of the 2012 reductions considered earlier - a second look at what is eligible may reap benefits. Furthermore, a surprise announcement in the Budget earlier this year has improved the scope for using this relief.

Up until now it has only been possible to make a SLA election on assets with an expected useful life to the business of four years or less from the end of the accounting period of acquisition. Therefore if the commercial vehicle in example 3 had been retained for one or two more years in the company business then it would become ineligible for SLA treatment and no additional allowance would have been granted on disposal.

This lifetime period has now been extended to eight years from the end of the accounting period of acquisition for additions on or after 1 April 2011 for companies or 6 April 2011 for the self-employed. This makes it more useful as it means more assets could benefit from a SLA election.

Two points to watch

First, a SLA election should only ideally be made on assets which are likely to lose value quicker than they receive tax relief. This is because where assets hold their value well this could result in a 'clawback' of some or all of the tax relief given.

Second, not all qualifying expenditure qualifies. Some assets are specifically excluded. The key (but not only) exceptions are cars, integral features and long life assets. Please contact us for further guidance on exclusions.

Timing of capital expenditure

The impending AIA reduction sharply brings into focus the importance of identifying the correct date for qualifying capital allowance expenditure. The normal rule is that expenditure is incurred on the date on which the obligation to pay becomes unconditional. This will often be the date goods are delivered.

There is an exception to this general rule. If there is a gap of more than four months between the date on which the obligation to pay becomes unconditional and the date on which payment is required to be made, the expenditure is not incurred until the date on which payment is required to be made.

Example 4

Peter buys an asset for £100,000 in his accounting period to 5 April 2012. This is his only plant expenditure. Under the contract he has to pay £50,000 when he takes delivery and £50,000 six months later. He takes delivery on 24 October 2011.

His obligation to pay for the asset becomes unconditional on 24 October 2011. He is, however, legally required to pay in two instalments - £50,000 on 24 October 2011 and £50,000 on 24 April 2012.

The second instalment is therefore due more than four months after the date on which his obligation to pay becomes unconditional. This means that the second instalment is not treated as incurred until 24 April 2012, the date on which he is legally required to pay for it.

What AIA is due?

The knock on effect of the above is that instead of the £100,000 being wholly covered by AIA in the year to 5 April 2012, the following occurs:

- £50,000 AIA is available on the first £50,000 in the year to 5 April 2012 providing 100% tax relief.
- Only £25,000 of the second £50,000 will qualify for AIA (due to the reduction in the limit) and the balance will attract WDA only.

Ensure claims are not missed

One hot topical issue concerns 'fixtures and fittings' in second hand building purchases. The need for accurate allocation of expenditure to those elements and identification of eligibility for plant and machinery capital allowances means that claims can initially be missed.

However, due to the fact that there is currently no time limit on when expenditure on plant or machinery, including fixtures, needs to be pooled, this means that such expenditure on fixtures can be pooled some years after the fixtures were acquired.

This facility to make 'late' claims, several years after a property acquisition may mean, due to the lack of relevant information available to HMRC about the previous owner's claims, that capital allowances are given to the current owner (as well as a previous owner).

Government may call time

Due to the above, the Government is considering the following proposals:

- a requirement that businesses must pool their expenditure on fixtures within a short period after acquisition, in order to qualify for capital allowances and
- that, in order to qualify for capital allowances, the purchaser of a second hand building must agree with the seller the amount of the sale price attributable to the fixtures, and that both the purchaser and the seller should record and formally notify this to HMRC within a similar timescale.

Further, in respect of expenditure already incurred on such fixtures, before any changes in the law come into effect, the Government is considering whether businesses should also be required to pool that expenditure within one or two years of the commencement of the mandatory pooling requirement for new expenditure.

If these proposals go ahead, early action to ensure that all relevant building purchases have been reviewed may become necessary to secure capital allowance claims.

Please do contact us for tailored capital expenditure and allowance advice for your business requirements so that tax savings can be maximised.

Disclaimer - for information of users - This briefing is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this briefing can be accepted by the authors or the firm.