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CAPITAL ALLOWANCES:
CHANGES TO THE ANNUAL INVESTMENT ALLOWANCE

Since its introduction in April 2008, the Annual Investment Allowance (AIA) has been subject to numerous changes. 1 January 2016 sees the latest change to the AIA, with the allowance set to fall from £500,000 to a new permanent level of £200,000. This reduction will undoubtedly have an impact on many businesses and the timing of expenditure will be critical when maximising claims under the AIA.

This factsheet provides an overview of the capital allowances system, and includes information on the upcoming changes to the AIA, as well as advice to help businesses plan ahead so that they receive the maximum tax benefit.

CAPITAL ALLOWANCES: AN INTRODUCTION

Capital allowances permit businesses and those carrying out other qualifying activities to write off the cost of capital assets, such as plant and machinery, against their taxable income. They take the place of depreciation, which is not allowed for tax purposes.

Plant and machinery includes:

- items that you keep to use in your business, including cars
- costs of demolishing plant and machinery
- parts of a building considered integral, known as 'integral features'
- some fixtures, e.g. fitted kitchens or bathroom suites
- alterations to a building to install other plant and machinery – this doesn't include repairs.

The allowances available depend on the type of asset you are purchasing.

THE ANNUAL INVESTMENT ALLOWANCE

The Annual Investment Allowance (AIA) enables businesses to deduct the full cost of plant and machinery (excluding cars – see later) from their profits in the year of purchase. It applies to businesses of any size and most business structures, but there are provisions to prevent multiple claiming. Businesses are able to allocate their AIA in any way they wish; so it is quite acceptable for them to set their allowance against expenditure qualifying for a lower rate of allowances (such as long life assets or integral features).

Apart from reducing the amount of tax payable (by up to 45% for additional rate taxpayers), an AIA claim can protect the personal allowance of a taxpayer earning over £100,000 in the initial year of purchase. However, the lowering of profits could have a dramatic effect on an individual's entitlement to claim Tax Credits, so it is important to seek expert advice before taking action.

How much can I claim?

The AIA was temporarily increased to £500,000 from 1 April 2014 for companies or 6 April 2014 for unincorporated businesses until 31 December 2015. It had been due to fall to £25,000 from 1 January 2016, but in his Summer Budget on 8 July the Chancellor George Osborne announced that the AIA will instead be set at a permanent limit of £200,000 from 1 January 2016.

However, transitional rules will have an impact on the amount businesses can claim, so timing will play a key role in determining how much AIA is available. It is especially important if you are experiencing a need to invest substantial amounts in plant and machinery.

Accounting periods spanning the change

Where an accounting period spans 31 December 2015, the maximum amount of AIA entitlement is calculated on a pro-rata basis. For example, if Company A's accounting period begins on 1 April 2015 and ends on 31 March 2016, approximately three quarters of that period would fall before the date of change (1 January 2016) and approximately one quarter would fall after that date.

Company A will be subject to a transitional AIA maximum, calculated as follows:

Dates	Fraction of period	Allowance for full year	Transitional allowance
01/04/15 to 31/12/15	9/12	£500,000	£375,000
01/01/16 to 31/03/16	3/12	£200,000	£50,000
	Transitional AIA maximum		£425,000

Timing expenditure for maximum relief

As demonstrated in the above example, the maximum AIA for expenditure incurred before 1 January 2016 is £425,000. However, where expenditure is incurred on or after 1 January to 31 March 2016, the maximum amount of relief will only be £50,000. Therefore, if you want to gain the maximum benefit of the £500,000 AIA, it may be advisable to purchase plant and machinery before 31 December 2015. If this is not an option, you might want to delay expenditure until after 31 March 2016, when the AIA will be set at £200,000. Note that tax relief will be deferred for a full year.

Another (though drastic) alternative would be to change the accounting period end to 31 December 2015 from 31 March 2016. The purchase in December 2015 would be in an accounting period which does not contain any changes in the AIA maximum. There could, however, be repercussions in terms of additional costs and possible advances of tax liability.

It is important to take a considered approach when planning expenditure. Any spending on plant and machinery should be commercially justifiable – there is no cash flow advantage to be gained by simply buying equipment to save tax.

Expenditure exceeding the AIA

Where a purchase exceeds the AIA (or the item does not qualify for the AIA, e.g. cars), a writing down allowance (WDA) is due on the excess. Any additional expenditure over the AIA level enters either the 8% pool or the 18% pool, attracting WDA at the appropriate rate. The special rate 8% pool applies to long life assets, the addition of thermal insulation to existing commercial buildings, and *integral features* of buildings, specifically:

- Electrical systems (including lighting systems)
- Cold water systems
- Space or water heating systems, powered systems of ventilation, air cooling or purification and any floor or ceiling comprised in such systems
- Lifts, escalators and moving walkways
- External solar shading.

The main 18% pool applies to most other plant and equipment, including cars.

Other points to consider

Special incentives for green investment

In addition to the AIA, investment in certain green technology may be eligible for enhanced capital allowances (ECAs). Under the ECA scheme, a 100% first year allowance is available on energy-saving or environmentally beneficial equipment. A list of the energy-efficient plant and machinery which qualifies for ECAs can be found on the Government's website: www.gov.uk/guidance/energy-technology-list.

Where companies (only) have losses arising from ECAs, they may choose how much they wish to carry forward and how much they wish to surrender for a cash payment (tax credit payable at 19%, subject to an upper limit).

A separate ECA scheme exists for new electric and low CO_2 emission (up to 75 g/km) cars and natural gas/hydrogen refuelling equipment. They still qualify for a 100% first year allowance, but do not qualify for the payable ECA regime.

The rules on cars

Currently, for cars purchased with CO_2 emissions exceeding 75 g/km, the main WDA rate of 18% applies. However, cars with CO_2 emissions above 130 g/km will be restricted to the special rate of 8%. For non-corporates, cars with a non-business use element continue to be dealt with in single asset pools, so the correct private use adjustments can be made but the rate of WDA will be determined by the car's CO_2 emissions.

Buildings

When a building is purchased for business use, capital allowances can be claimed on plant elements contained therein, e.g. air conditioning (subject to certain conditions). A maximum 100% initial business premises renovation allowance is available for converting or renovating unused business premises within designated assisted areas. WDA of 25% (on a straight line basis) applies to expenditure on which an initial allowance is not claimed.

Making a claim

Both unincorporated businesses and companies must make a claim for capital allowances via the tax return. To receive the full value under the AIA or first year allowance, the claim must be made in the accounting period in which the item(s) were purchased.

However, there may be instances where it is not favourable to claim the full amount available. A claim can then be made for writing down allowances at any time as long as the asset is still owned. Where this is the case, unincorporated businesses must normally make the claim within 12 months after the 31 January filing deadline for the relevant return. For companies, the claim must normally be made within two years of the end of the accounting period.

Utilising capital allowances can result in significant savings for your business. However, the rules can be complex and it is important to consider the timing of any expenditure you are planning to help maximise the relief available. Please contact us if you would like further information or advice.