

## Business tax

### Basic capital allowances

The calculation of capital allowances is a topic that is always covered in the computer based assessment (CBA), it is a complex area and knowledge of all aspects must be fully understood. In this module we will start to look at the basics:

- the definition of capital allowances
- the type of expenditure that qualifies for capital allowances
- capital allowance rates
- first year allowance (FYA) and annual investment allowance (AIA) calculations.

### The definition of capital allowances

Many businesses will purchase non- current assets, for example motor vehicles, plant and machinery, computer and office equipment. These items cannot be deducted as expenditure from trading income; instead they may be eligible for capital allowances. Sole traders, partnerships and companies are all able to claim capital allowances.

### Qualifying expenditure for capital allowances on plant and machinery

The main types of expenditure on which capital allowances can be claimed are on the purchase of:

- motor vehicles
- office equipment
- machinery
- computers
- tools.

The above list is referred to as plant and machinery.

Capital allowances may also be claimed on buildings and renovation, but knowledge of this area is not required for the business tax assessment.

Each item of plant and machinery that is purchased must initially be categorised as expenditure qualifying for/as:

- an FYA
- the AIA
- the special rate pool
- the main pool
- a short life asset
- an asset with private use.

For each purchase the first step will be to see if it qualifies for a FYA or AIA.

The details for each category are:

### 1. FYA

The following expenditure will qualify for a FYA:

- energy saving, water efficient and vehicle gas refuelling equipment
- new cars with very low carbon dioxide (CO<sub>2</sub>) emissions of less than 111g/km.

### 2. AIA

This allowance is available on most plant and machinery expenditure, except for cars (for further details see the section on AIA calculations).

### 3. the special rate pool includes:

- long life assets (having a useful life exceeding 25 years)
- cars with CO<sub>2</sub> emissions that are over 160g/km.

### 4. the main pool

This will include expenditure on most items that are not in the categories above or classed as a private use or short life asset.

Let's test your knowledge, categorise each of the plant and machinery purchases (which are all used wholly and exclusively for business purposes) below by selecting all the categories on which capital allowances can be claimed for each purchase.

|   | FYA   | AIA  | Special rate pool  | Main pool   |
|---|---|--|--|---|
| A van with CO <sub>2</sub> emissions of 120g/km purchased by an electrician         |   | ✓ A van is not a motor car but will qualify as plant, therefore it may be eligible for AIA |  | ✓ If the van is not eligible for AIA it will be put into the main pool    |
| A water efficient washing machine purchased by a hairdresser                        | ✓ Water efficient equipment is eligible for the FYA |  |  |   |
| A laptop purchased by an accountant   |   | ✓ A laptop may be eligible for AIA   |  | ✓ If the laptop is not eligible for AIA it will be put into the main pool |
| A car with CO <sub>2</sub> emissions of 200g/km purchased by a marketing consultant |   |  | ✓ A car with CO <sub>2</sub> emissions over 160g/km will be put into the special rate pool |   |

### Rates for capital allowances on plant and machinery

There are different rates for capital allowances that are dependent on the category of expenditure. The rates for the Finance Act (FA) 2012 are:

- FYA – 100%

- AIA – up to £25,000 (FA 2011 up to £100,000)
- writing down allowance – special rate pool – 8% (FA 2011 – 10%)
- writing down allowance – main pool – 18% (FA 2011 – 20%).

### FYA calculations

The FYA calculation is very simple as the rate is currently 100%. There are no restrictions on the amount that can be claimed and it is not reduced if the accounting period is for less than twelve months.

Let's look at an example.

Jane has a hair salon and she purchased a water efficient washing machine for £1,500 on 1 December 2012. She prepares accounts to 31 March 2013. The relevant extract from her capital allowances computation will appear as follows:

|  | FYA 100% (£) |
|--|--------------|
| Addition                               | 1,500        |
| FYA                                    | (1,500)      |
| Written down valuation carried forward | 0            |

Note: refer to the *Business tax factsheet* for a more detailed layout of the capital allowances computation.

### AIA calculations

The calculation of the AIA may be a bit trickier to calculate as there are more rules to consider.

1. The AIA was reduced from £100,000 to £25,000 from 1 April 2012 for companies and 6 April 2012 for sole traders and partnerships; this means that a claim may be made on plant and machinery (excluding cars) of up to £25,000 per annum.
2. If over £25,000 has been spent, the balance will be transferred either to the main pool or special rate pool (depending on the type of expenditure), and the balance will attract capital allowances at 18% or 8%.

For example, Carol Ltd has a year end 31 March 2013 and during the year she purchased qualifying plant and machinery for £30,000.

To see the extract from her capital allowances computation click to [display](#)/[hide](#) the solution.

|  | AIA (£)  | Main pool (£) | Total allowances (£) |
|--|----------|---------------|----------------------|
| Additions                              | 30,000   |               |                      |
| AIA                                    | (25,000) |               | 25,000               |
| Transfer to main pool                  | (5,000)  | 5,000         |                      |
| Writing down allowance at 18%          |          | (900)         | 900                  |
| Written down valuation carried forward | 0        | 4100          |                      |
| Total allowances                       |          |               | 25,900               |

3. If the accounting period is for less than twelve months, the annual investment allowance will be reduced on a pro rata basis.

George has prepared accounts for the nine months ended 31 December 2012. Calculate the maximum AIA he is entitled to.

Click to display/hide the solution.

The maximum annual investment allowance is £18,750 (£25,000 x 9/12).

4. If the accounting period spans the 1 April (companies) to 6 April (sole traders and partnerships) 2012 the AIA will be time apportioned between £25,000 (FA 2012 limit) and £100,000 (FA 2011 limit).

For example, Keyes Ltd prepares accounts to 31 December 2012, the maximum AIA is:

- for the three months to 31 March 2012 – £25,000 (£100,000 x 3/12)
- for the nine months to 31 December 2012 – £18,750 (£25,000 x 9/12).

This means that up to £25,000 can be claimed in the period to 31 March 2012 and up to £18,750 in the period to 31 December 2012.

Have a go at the question below to test your knowledge.

In the year ending 31 December 2012 Keyes Ltd purchased the following:

- 1 January 2012 low emission car - £15,000
- 1 January 2012 office equipment - £20,000
- 1 May 2012 computer equipment - £23,000

Prepare the capital allowances computation for the year ending 31 December 2012, there are no balances brought forward.

Use a composite writing down allowance of 18.25% as the accounting period spans both FA 2011 and FA 2012.

Click to display/hide the solution.

|  | FYA      | AIA (£)  | Main pool (£) | Total allowances (£) |
|--|----------|----------|---------------|----------------------|
| Additions                              | 15,000   | 43,000   |               |                      |
| FYA                                    | (15,000) |          |               | 15,000               |
| AIA                                    |          | (38,750) |               | 38,750               |
| Transfer to main pool                  |          | (4,250)  | 4,250         |                      |
| Writing down allowance at 18.25%       |          |          | (776)         | 776                  |
| Written down valuation carried forward |          | 0        | 3,474         |                      |
| <b>Total allowances</b>                |          |          |               | <b>54,526</b>        |

The maximum that can be claimed as an AIA for the three months to 31 March 2012 is £25,000; as the office equipment costs less than this only £20,000 can be claimed. The maximum that can be claimed as an AIA for the nine months to 31 December 2012 is £18,750; as the computer equipment costs £23,000 the amount that can be claimed is restricted to £18,750 and the balance is transferred to the main pool.