



## Business tax

### Basic capital allowances (FA2015)

In this module we will look at the key topics, work through a detailed example and give you the opportunity to attempt a practice question

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:

1. the definition of capital allowances;
2. the type of expenditure that qualifies for capital allowances;
3. capital allowance rates;
4. 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:

- a first year allowance
- the annual investment allowance
- 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 first year allowance or annual investment allowance.

The details for each category are:

### **1. first year allowance (FYA)**

The following expenditure will qualify for a first year allowance:

- energy saving and water efficient equipment
- new cars which are either electric or have with very low carbon dioxide (CO<sub>2</sub>) emissions of less than 76g/km
- new zero emission goods vehicles

### **2. annual investment allowance (AIA)**

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

### **3. the special rate pool, includes:**

- long life assets (having a useful life exceeding 25 years)
- cars with CO<sub>2</sub> emissions which are over 130g/km

### **4. the main pool**

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

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\*The further two categories, short life assets and private usage will be covered in another module.

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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:

Check your answer by selecting

	<u>First Year Allowance (FYA)</u>	<u>Annual Investment Allowance (AIA)</u>	<u>Special Rate Pool</u>	<u>Main Pool</u>
A van with CO2 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 CO2 emissions of 200g/km purchased by a marketing consultant			✓ A car with CO2 emissions over 130g/km will be put into the special rate pool	

### Rates for capital allowances on plant and machinery

There are different rates for capital allowances which are dependent on the category of expenditure, the rates for the Finance Act 2015 (FA 2015(1)) are:

- first year allowance – 100%
- annual investment allowance – up to £500,000 to 31 December and up to £25,00 from 1 January 2016 (FA 2014 up to £500,000)
- writing down allowance – special rate pool – 8%
- writing down allowance – main pool – 18%

## First year allowance calculations

The first year allowance 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 £15,000 on 1 December 2015, she prepares accounts to 31 March 2016 .**

**The relevant extract from her capital allowances computation will appear as follows:**

	<u><b>First Year Allowance</b></u>
	<u><b>100%</b></u>
	<u><b>£</b></u>
<b>Addition</b>	<b>15,000</b>
<b>First year allowance</b>	<b>(15,000)</b>
<b>Written down valuation carried forward</b>	<u><u><b>0</b></u></u>

## Annual investment allowance calculations

The calculation of the annual investment allowance may be a bit trickier to calculate as there are more rules to consider:

1. The annual investment allowance is £500,000 to 31 December 2015 and £25,000 from 1 January 2016. For the year ended 31 March 2016 the maximum entitlement to AIA for the year is:  
 $9/12 \times £500,000 + 3/12 \times £25,000$ , £381,250.

Note that even though the maximum entitlement for the year to 31 March 2016 is £381,250, if the company incurred no expenditure in the 9 months to 31 December 2015 and £75,000 in the remaining 3 months of the year then the maximum AIA claim would be £6,250 ( $3/12 \times £25,000$ ).

2. If more than the AIA limit on either side of the AIA limit change date 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 2016 and during the year purchased qualifying plant and machinery for £550,000 - £325,000 on 1 June 2015 and £225,000 on 1 February 2016.**

**To see the extract from her capital allowances computation select**

	<b>Annual Investment Allowance £</b>	<b>Main Pool £</b>	<b>Total Allowances £</b>
<b>Additions to 31 December 2015</b>	325,000		
<b>Annual investment allowance (Max. £375,000)</b>	<u>(325,000)</u>	0	325,000
<b>Additions from 1 January 2016</b>	225,000		
<b>Annual investment allowance</b>	<u>(6,250)</u>	218,750	6,250
<b>Writing down allowance at 18%</b>		(39,375)	39,375
<b>Written down value carried forward</b>	<u>0</u>	<u>179,375</u>	
<b>Total allowances</b>			<u><u>370,625</u></u>

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 2015. Calculate the maximum entitlement to annual investment allowance.**

**Select**                      **to see the answer:**

**The maximum annual investment allowance is £375,000 ( $£500,000 \times 9/12$ )**

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

Select  to see the answer.

In the year ending 31 December 2015 Keyes Ltd purchased the following:

- 1 January 2015 low emission car - £15,000
- 1 January 2015 office equipment - £250,000
- 1 May 2015 computer equipment - £262,500

Prepare the capital allowances computation for the year ending 31 December 2015, there are no balances brought forward.

	FYA £	AIA £	Main Pool £	Total Allowances £
Additions	15,000	512,500		
First year allowance	(15,000)			15,000
Annual investment allowance		(500,000)		500,000
Transfer to main pool		(12,500)	12,500	
Writing down allowance at 18%			(2,250)	2,250
Written down valuation carried forward		<hr/>	<hr/>	
		0	10,250	
Total allowances				<hr/> 517,250 <hr/>