

CAPITAL ALLOWANCES – THE ANNUAL INVESTMENT ALLOWANCE

What is the Annual Investment Allowance (AIA)?

In simple terms, the AIA is a 100% first-year allowance for business expenditure on almost all plant and machinery (apart from cars). It is capped at £50,000 of expenditure per year.

All types of business, whether sole traders, partnerships or companies, can potentially use the AIA to reduce taxable trading profits by qualifying expenditure of up to £50,000 per year incurred on or after 1 April 2008 (companies) or 5 April 2008 (unincorporated businesses).

Qualifying expenditure includes assets bought on a hire-purchase basis. Even though an asset bought on hire purchase is paid for over a number of years, relief can be gained for up to 100% of the capital amount, in the year of acquisition. A deduction is also available for Interest charged under hire purchase arrangements (albeit restricted for high emission cars).

The AIA is restricted in some circumstances, for example where the chargeable period is less than 12 months, where there is non-business use of an asset by an unincorporated business, and where two or more businesses under common control are related.

Interaction with other allowances

Expenditure in excess of the available AIA qualifies for a Writing Down Allowance of 20% or 10% in the year of acquisition, and each subsequent year on a reducing balance basis.

Assets that qualify for a Writing Down Allowance of only 10% include cars with emissions above 160g/km and certain “integral features” of buildings, which may include electrical systems (including lighting), cold water systems, heating and air conditioning systems, and thermal insulation.

For the 12-month period beginning 1 April 2009 for companies, and 6 April 2009 for unincorporated businesses, any new expenditure (excluding cars and leased assets) temporarily qualifies for an enhanced writing down allowance of 40%.

Certain energy-saving and water-efficient equipment, new electric and low emission cars qualify for a First Year Allowance of 100%.

Tax planning opportunities usually arise where a business acquires assets; with careful selection of the most appropriate capital allowances, maximum relief can be gained in the year of expenditure.

An example

Bob, a farmer and sole trader, prepares accounts to 31 March each year. In the year ended 31 March 2010, he has the following transactions:

1. Buys a van on hire purchase on 1 April 2009, the van costs £9,000 (net of VAT) and under the agreement Bob has to make 48 monthly payments of £220
2. Buys other qualifying machinery for £40,000
3. Buys a computer for the office for £1,500
4. Sells old equipment for £2,000 (original cost £4,000)

Bob has assets with a tax written down value (TWDV) of £10,000 brought forward from the previous period.

The maximum capital allowances available to Bob for the year ended 31 March 2010 are calculated as follows:

	Enhanced WDA	Main rate	Allowances
TWDV b/f		10,000	
Disposals		(2,000)	
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		8,000	
 Additions			
- max. qualifying for AIA		50,000	
- balance; eligible 40% WDA	500		
AIA		(50,000)	50,000
WDA 40%/ 20%	(200)	(1,600)	1,800
Transfer to pool	(300)	300	
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TWDV c/f		6,700	
Allowances			<hr style="width: 50%; margin-left: auto; margin-right: 0;"/> 51,800

In addition, Bob will get relief for the interest charged under the hire purchase arrangement, amounting to $((48 \times £220) - 9,000) = £1,560$ over the term of the agreement.

In cash terms, for the year ended 31 March 2010 Bob has net cash outflows of £42,140 but gets deductions for the capital allowances, £51,800, plus the interest on the hire purchase, $(12/48 \times £1,560) = £390$, i.e. total deductions from trading profits of £52,190.

Conclusion

Capital allowances can be a complex area and the matters discussed above have, necessarily, been simplified.

Nevertheless, the introduction of the AIA and other recent changes to the capital allowances regime clearly have provided new tax planning opportunities which need to be borne in mind by all business owners when considering new capital investments.

If you have any questions about the issues covered in this update or if you would like to discuss anything in more detail, we are here to help. Contact us on 01856 872983 or by e:mail at enquiries@ajbscholes.co.uk.