

The ups and downs of capital allowances

The proposed changes from April 2008

In his budget statement on 21 March 2007 the Chancellor announced a major overhaul of the capital allowances regime from April 2008 (the operative dates being 6 April 2008 for individuals and 1 April 2008 for companies). HMRC have recently released a technical note setting out the changes in more detail, together with draft legislation. The changes can be summarised under three headings:

- Changes to existing allowances;
- The introduction of a new class of assets eligible for capital allowances, entitled "integral features" of a building; and
- The introduction of a new form of relief – the Annual Investment Allowance (AIA).

Changes to existing allowances

- The main rate of capital allowances on the general pool of plant and machinery will be reduced to 20% (currently 25%).
- The rate of capital allowances for expenditure on long life assets will increase to 10% (currently 6%).
- There will be a phased withdrawal of industrial buildings allowances (including hotel buildings allowances) (IBAs) and agricultural buildings allowances (ABAs). These will be reduced from their current rate of 4% by 1% each year until full withdrawal from April 2011. The annual allowance on buildings acquired second hand will be scaled down at a similar rate. Balancing adjustments resulting from balancing events (e.g. sales) have already been abolished for all such events occurring after 20 March 2007 (except for events occurring pursuant to certain contracts made on or before that date).
- First year allowances (currently given to small enterprises at the rate of 50% and to medium sized enterprises at the rate of 40%) will be withdrawn for expenditure incurred from April 2008.

Integral features

These are a defined class of assets which are integral to a building or structure. The list as set out in the proposed legislation consists of:

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

Assets whose principal purpose is to insulate or enclose the interior, or to provide an interior wall, floor or ceiling which is intended to remain permanently in place, are specifically excluded.

Expenditure on such assets from April 2008 will qualify for allowances as plant and machinery at the rate of 10%.

The effect of this is mixed:

- Some items which would currently qualify for relief at the 25% rate of writing down allowance for general plant and machinery (such as lifts) will now be given a writing down allowance of 10% only;
- Other items (such as most lighting installations and cold water systems) will now qualify for a 10% writing down allowance, having previously only been eligible for IBAs or ABAs, or for no relief at all if installed in buildings which did not qualify for these allowances.

Expenditure on thermal insulation currently eligible for relief as plant and machinery, although not an integral feature as defined above, will qualify as plant and equipment for a 10% writing down allowance. Relief will no longer be restricted to expenditure on industrial buildings.

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Annual Investment Allowance (AIA)

This will be a new annual investment allowance of 100% for up to £50k of investment in plant and machinery from April 2008. The maximum amount is increased or reduced proportionately for accounting periods of less or more than 12 months. For accounting periods which straddle April 2008, the maximum amount is reduced by time apportionment – so that, for example a company which prepares accounts for the year ended 30 September 2008 will have a maximum AIA for that year of $6/12 \times £50k = £25k$.

Certain assets which are currently ineligible for first year allowances (including motor cars) will not qualify for AIA. However, integral features and long life assets will not be excluded. Where total eligible expenditure in a chargeable period exceeds the limit, the taxpayer may choose the expenditure on which he wishes to claim AIA, and may thus accelerate relief on expenditure which would otherwise have qualified for relief at the lower rate of 10%. Expenditure on environmentally beneficial plant and machinery will continue to qualify for a separate 100% first year allowance and will not fall to be included in a claim for AIA.

The relief will generally be available to all businesses (both trading and property businesses) regardless of size or legal form, although trusts and “mixed” partnerships whose members include both individuals and companies, which currently are ineligible for first year allowances, will also not be able to claim AIA.. Only one £50k allowance will be available to each group of companies, and there are also provisions which in certain circumstances will cause the allowance to be shared between entities under common control, as well as other provisions to prevent abuse of the relief.

Planning considerations - ongoing

It is important that:

- expenditure on new construction is scrutinised to ensure that all expenditure on plant and machinery, including integral features, is identified and the available reliefs are utilised to the fullest extent; and
- where an existing building or business is being acquired, careful thought is given to the allocation of purchase consideration between buildings, integral features, other plant and machinery and business goodwill.

This should especially be borne in mind in relation to industrial, hotel and agricultural buildings in view of the withdrawal of relief currently available under the IBA and ABA provisions for expenditure which is regarded as not being in respect of plant and machinery.

Smaller businesses should consider whether they can arrange for expenditure eligible for AIA to be incurred evenly in order to avoid as far as possible years in which expenditure peaks at over £50,000.

Planning considerations – the transition

Consideration should be given to arranging the timing of proposed capital expenditure in order to obtain the best possible rates of allowance. It may be possible to:

- incur before April 2008 expenditure which is currently eligible for capital allowances as plant and equipment but which will fall into the integral features category in the future;
- incur before April 2008 expenditure which will currently qualify for first year allowances (unless it is likely to fall within the AIA limit);
- defer until April 2008 expenditure on plant and machinery which will qualify for AIA;
- defer until April 2008 expenditure on integral features which does not currently qualify for plant and machinery allowances.

This is a summary of the main provisions, which are in draft form and subject to change. It is for information only and does not constitute professional advice. For further information, advice or assistance in relation to any of the matters raised please speak to your usual Dixon Wilson contact or to the authors:



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