WHITE PAPER

A Business Guide to: Capital Allowances

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Understanding how to maximise tax relief is a cornerstone of sound financial management.

Executive Summary

Navigating the world of business finance can often feel like a complex puzzle and understanding how to maximise tax relief is a cornerstone of sound financial management.

Among the most valuable tools available to UK businesses are Capital Allowances. While the concept might sound intimidating, it is essentially the tax equivalent of claiming depreciation on your business assets.

This guide will demystify Capital Allowances, explaining what they are, how they work, and why they are a crucial consideration for any business owner looking to invest in their future.

1. What are Capital Allowances?

Capital Allowances allow a business to deduct the cost of certain assets from its taxable profits.

This is different from day-to-day business expenses such as salaries or rent, which are fully deductible in the year they are incurred. Instead, Capital Allowances apply to longer-term assets like machinery, vehicles, computers, or elements of a building that are used over time to generate income.

HMRC doesn't allow the entire cost of a capital asset to be claimed as an expense in one go. Instead, Capital Allowances provide a mechanism to obtain tax relief over time, using rates set by legislation. These rates do not always match the actual useful life of the asset but provide a structured method of spreading relief.

1.1 Embedded capital allowances

Not a statutory term, but widely used in the industry to mean **the plant and machinery that is embedded within a building** when it is purchased.

These allowances reduce your taxable profits, potentially saving significant amounts in tax, especially for property investors, developers, or businesses that own commercial property.

"Embedded" refers to plant and machinery that is permanently fixed in a property and forms part of the building, such as:

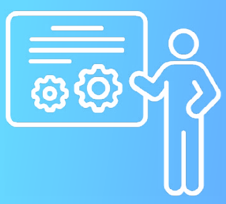
- Heating systems
- Air conditioning
- Electrical systems
- Lifts
- Toilets and sanitary fittings
- Kitchen fittings
- Fire alarm and security systems

These are not easily removable, but they qualify for capital allowances under UK tax law.

If you imagine you could pick your commercial building up turn it upside down and give it a shake. Anything that falls out will be covered under main pool capital allowances – something which an accountant will more than likely deal with. However, anything that does not fall out, i.e wiring, plumbing, etc, is what ABGi would identify.

We offer a free no-obligation audit using your fixed asset register and tax computations to see if there is potentially a missed opportunity or if within the last 2 financial years a miscategorisation has taken place due to the complexities of these type of capital allowances.

2. How Do They Work?



There are several types of Capital Allowances, **each with its own rules and rates**:

2.1 Annual Investment Allowance (AIA)
2.2 Writing Down Allowances (WDAs)
2.3 Structures and Buildings Allowance (SBA)
2.4 Purchase claim capital allowances
2.5 Full Expensing

2.1 The Annual Investment Allowance (AIA)

What is the AIA?

The AIA is a tax relief that allows businesses to deduct the full value of qualifying capital expenditure from their taxable profits in the year the expenditure is incurred. It's a "100% first-year allowance" on certain assets, which means businesses get immediate tax relief, rather than spreading the cost over several years through Writing Down Allowances. This has a direct and positive impact on a business's cash flow.

The Current Limit

As of April 2023, the AIA limit has been permanently set at £1 million per year. This is a crucial change as the limit had previously fluctuated. The government's decision to make the £1 million limit permanent provides certainty and stability for businesses when planning their long-term investments.

Did you know?

A "Shaking Test" for Fixtures:
For many years, a simple, non-legal rule of thumb for identifying what qualified as "plant and machinery" within a building was the "shaking test."

If you tipped a building upside down, anything that fell out (like desks, chairs, and computers) was considered loose plant and machinery. The fixtures that stayed put (like lifts, air conditioning, and electrical wiring) were considered part of the building and were generally not claimable.

This simple test is a bit outdated now due to changes in the rules, but it illustrates the historic distinction.

2.1 The Annual Investment Allowance (AIA) *(cont)*

Who can claim it?

The AIA is widely available to a variety of UK business structures, including:

- ✓ Sole traders
- ✓ Limited companies
- ✓ Partnerships (as long as all partners are individuals)

There are some restrictions, for example, two or more limited companies under common control must share a single AIA allowance.

What expenditure qualifies?

The AIA applies to most "plant and machinery" that a business purchases. This is a very broad category and can include:

- » **Office equipment:** Computers, printers, desks, and chairs.
- » **Business vehicles:** Vans, lorries, and some other commercial vehicles. However, it's important to note that cars are generally excluded from the AIA.
- » **Machinery:** Manufacturing equipment, tools, and industrial machinery.
- » **Fixtures and fittings:** This includes "integral features" of a building, such as electrical systems, heating and ventilation, hot and cold water systems, lifts, and air conditioning.
- » **Second-hand assets:** Unlike some other allowances, the AIA can be claimed on both new and second-hand qualifying assets.

How it works in practice

Let's look at **a simple example:**

If your limited company has a taxable profit of £200,000 and you spend £150,000 on new machinery that qualifies for the AIA, you can deduct the full £150,000 from your profits. **This reduces your taxable profit** to £50,000, significantly lowering your Corporation Tax bill for that year.

Key points to remember

- **Timing is key:** You can only claim the AIA in the accounting period in which you incur the expenditure.
- **What if you exceed the limit?** If your qualifying expenditure goes over the £1 million limit, you can't carry over the unused AIA. Instead, any expenditure above the cap would be claimed using Writing Down Allowances.
- **It's not an obligation:** You are not required to claim the full AIA. If your profits are low in a particular year, you may choose to claim a lower amount and carry the rest forward using Writing Down Allowances.
- **No claims on closure:** You cannot claim the AIA on assets purchased in your final accounting period before your business ceases trading.

Did you know?

Cars have their own rules: Generally, cars are excluded from the generous 100% Annual Investment Allowance. However, specific rules apply, with new zero-emission cars still qualifying for a 100% first-year allowance. This is a government incentive to encourage greener transport.

Did you know?

A Pub's Decor can be "Plant": In a famous legal case, a pub company successfully argued that the decorative assets in its establishments (such as murals and tapestries) were "plant." The court agreed that these items, by creating a specific atmosphere, were essential to the trade of a modern pub and therefore qualified for an allowance.

2.2 Writing Down Allowances (WDAs)

WDAs are a core part of the UK's capital allowances system, offering a way for businesses to claim tax relief on assets over time.

While the Annual Investment Allowance (AIA) and Full Expensing provide immediate relief, WDAs are the primary method for long-term deduction.

How They Work

WDAs are calculated on a "reducing balance" basis. This means that each year, you claim a percentage of the remaining value of a pool of assets, not the original cost. This process continues annually until the value of the assets in the pool is reduced to zero..

The key difference from other allowances is that WDAs provide gradual, rather than immediate, tax relief. This is particularly useful for businesses that have spent more than their Annual Investment Allowance limit or on assets that do not qualify for a 100% first-year allowance.

WDA Pools and Rates

Qualifying assets are sorted into different "pools," each with its own specific rate of allowance. The two main pools are:

- **Main Pool:** This includes most plant and machinery. The current rate is 18% per year on the reducing balance. This covers common business assets like office equipment, computers, software, and commercial vehicles.
- **Special Rate Pool:** This pool is for assets with a longer working life or integral features of a building. The current rate is 6% per year on the reducing balance. This includes things like:
    - Integral features of a building (e.g., electrical systems, lighting, heating, lifts, and air conditioning).
    - Long-life assets (those with an expected useful life of 25 years or more).
    - Thermal insulation.
    - Cars with higher CO_2 emissions (over a certain threshold).

2.2 Writing Down Allowances (WDAs) *(cont)*

The Process for Claiming

1. **Allocate the expenditure:** Any qualifying expenditure that doesn't fall under the Annual Investment Allowance (e.g., because you've already used up your £1 million limit or the asset doesn't qualify, like a car) is added to the relevant WDA pool.
2. **Calculate the allowance:** At the end of each accounting period, you calculate the allowance by applying the correct rate (18% for the main pool, 6% for the special rate pool) to the total value in the pool.
3. **Deduct from profits:** The calculated allowance is then deducted from your business's taxable profits for that year.
4. **Carry forward:** The remaining balance in the pool is carried forward to the next accounting period, where the process is repeated.

Key Things to Know

- **Residual Allowance:** If the value of a pool drops to £1,000 or less, you can claim the full remaining balance as a WDA in that year, allowing you to clear the pool.
- **Balancing Charges/Allowances:** When a pooled asset is sold, the proceeds are deducted from the pool's balance. If the proceeds are greater than the pool's value, the difference is added back to your taxable profits as a "balancing charge." If the pool's value is higher, you can claim a "balancing allowance." This ensures that the correct amount of tax relief is ultimately given.
- **No Time Limit:** There is no time limit for claiming WDAs. You can continue to claim them as long as the assets are in use within your business.

Example

Imagine a company buys £1.2 million worth of new machinery in a single year.

- They can claim the full **£1 million AIA** in the first year, leaving a balance of £200,000.
- This remaining **£200,000** is added to **the main WDA pool.**
- In the first year, they can also claim an 18% WDA on this balance, which is **£36,000.**
- The balance in the pool is now reduced to £164,000 (£200,000 - £36,000).
- In the second year, they can claim 18% of the new balance (£164,000), which is **£29,520**, and so on.

2.3. Structures and Buildings Allowance (SBA)

The Structures and Buildings Allowance (SBA) is a tax relief introduced in the UK to incentivise business investment in non-residential property. It fills a significant gap that existed for a long time in the UK's capital allowances system.

What is the SBA?

The SBA provides a tax deduction for the cost of constructing or renovating new and existing commercial buildings and structures. Before the SBA was introduced in October 2018, businesses could claim tax relief on fixtures and plant & machinery within a building, but not on the building's core structure itself. The SBA changed this, making it a critical consideration for anyone buying, building, or renovating commercial property.

How Does it Work?

Unlike the Annual Investment Allowance or Writing Down Allowances, the SBA is claimed on a "straight-line" basis, which means the same amount is claimed each year.

THE RATE	The current rate is 3% per year.
THE PERIOD	This rate is applied over a period of 33 and a third years.
THE TIMING	The claim period begins on the later of either the date the qualifying expenditure was incurred or the date the building was first brought into non-residential use.
WHAT DOES THIS MEAN?	This means that a business will get the same amount of tax relief each year for over three decades, providing a predictable and long-term benefit.

Did you know?

A Building's Skeleton can now qualify: Until 2018, there was no tax relief for the shell of a commercial building. This changed with the introduction of the Structures and Buildings Allowance (SBA). This allowance now provides a tax deduction for the cost of the structural works of a new commercial building, bringing the UK's approach closer to that of other countries.

2.3. Structures and Buildings Allowance (SBA) *(cont)*

What Expenditure Qualifies?

The SBA applies to a wide range of costs related to the physical construction of a building, including:

- **Construction costs:** The direct costs of building the structure, including the foundations, walls, and roof.
- **Design fees:** Costs for architects, surveyors, and engineers.
- **Site preparation:** This includes the costs of demolition work and land alterations that are necessary to prepare the site for construction.
- **Renovation and conversion costs:** The expenditure on refurbishing or converting an existing commercial building.

It's crucial to note what **is excluded** from the SBA:

- **Land:** The cost of the land itself is not eligible.
- **Residential properties:** The SBA does not apply to residential buildings, such as private dwellings or student accommodation. However, certain exceptions exist for hotels and care homes.
- **Assets that qualify for other allowances:** Any items that are eligible for Plant and Machinery Allowances (like integral features, lifts, or electrical systems) should be claimed separately at a higher rate and are excluded from the SBA.

The Importance of the "Allowance Statement"

A unique and crucial aspect of the SBA is **the Allowance Statement.** To make a claim, a business must have a written statement that contains:

- **Information to identify the building.**
- **The date of the earliest construction contract.**
- **The total qualifying construction costs.**
- **The date the building was first used for a non-residential activity.**

This statement is vital because if a commercial property is sold, the seller must pass this document to the new owner for them to continue claiming the remaining allowances. Without this statement, the new owner cannot claim the SBA, which can significantly devalue the property.

How it Differs from Other Allowances

Unlike other allowances, t**here are no balancing charges or allowances** when a building is sold. Instead, the buyer simply inherits the remaining years of the SBA claim, continuing to claim the 3% deduction on the original qualifying cost.

In summary, the SBA provides valuable, long-term tax relief on the core structure of a commercial property. While the annual deduction is small, it adds up to a significant financial benefit over more than three decades, making it a key consideration for any business investing in commercial real estate.

2.4. Purchase claim capital allowances

A purchase claim capital allowance is a tax relief you can claim after buying a commercial property, based on the qualifying plant and machinery embedded in that property at the time of purchase.

This type of claim allows you to offset part of the purchase price against your taxable profits, potentially saving a significant amount of tax over time over time.

What is a Purchase Claim?

When you buy a commercial property, you're not just buying bricks and mortar, you're also buying embedded fixtures and features like:

- **Electrical and lighting systems**
- **Heating and air conditioning**
- **Lifts**
- **Fire alarms and security systems**
- **Sanitary fittings**
- **Kitchens, built-in cupboards, etc.**

These qualify as plant and machinery under UK tax law and are therefore eligible for capital allowances.

Requirements for a Purchase Claim

To make a successful purchase claim:

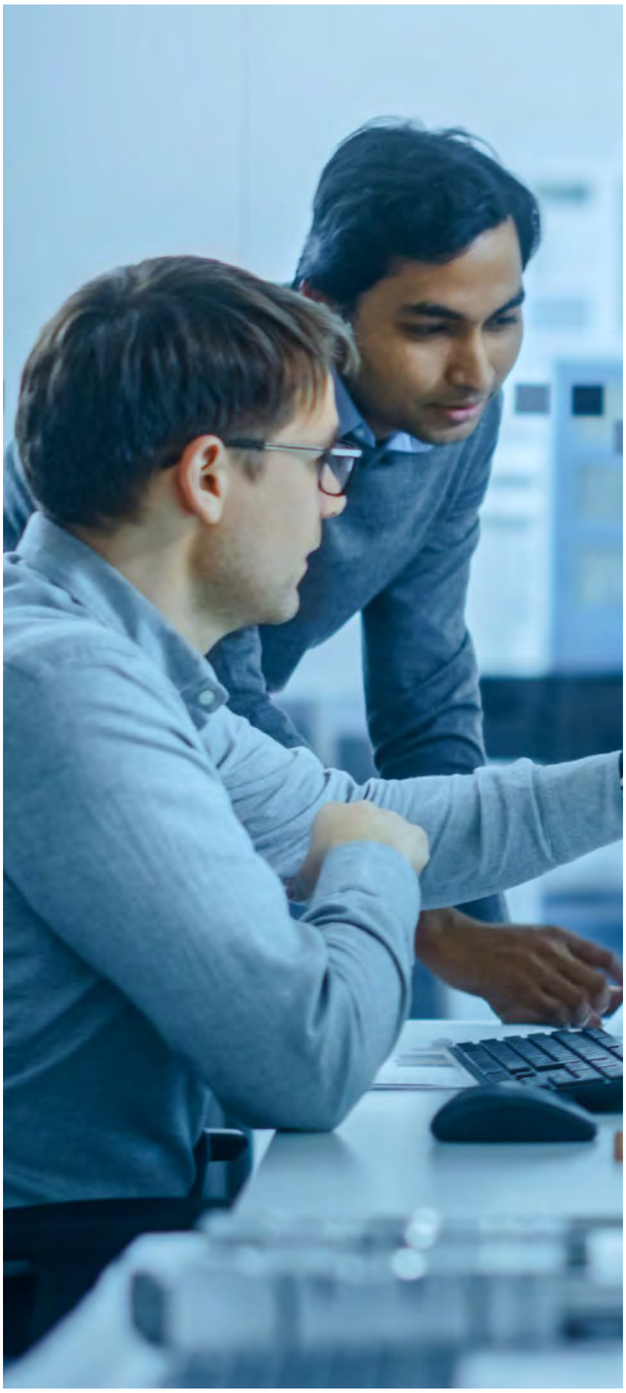
1. The property must be commercial, e.g.: Offices, Warehouses, Retail units, Hotels or care homes, Furnished holiday lets (in some cases)

2. The fixtures must still be in use within your business.

3. A Section 198 election (UK-specific) should usually be agreed between buyer and seller, this states how much of the sale price relates to the embedded fixtures.

4. You (or a specialist) must conduct a capital allowances survey to identify and value the qualifying assets.

"A purchase claim identifies the value of these qualifying items already in place at the time of purchase and lets you claim tax relief on them.



2.4. Purchase claim capital allowances *(cont)*

EXAMPLE:

» You buy a warehouse for £1,000,000. Through a specialist survey, it's determined that £300,000 of that price relates to qualifying embedded fixtures.

	You can claim capital allowances on the £300,000.
	This may be claimed over time or, in some cases, more quickly via the Annual Investment Allowance (AIA) currently allowing 100% of qualifying costs to be claimed in year 1 (up to £1 million per year, subject to rules).
	If you're a 25% corporation tax payer, this could result in **up to £75,000** in tax savings.

Important

- You cannot claim again if the previous owner already claimed capital allowances and "passed on" a £0 value via the Section 198 election.
- You generally need to make the claim within 2 years of purchase to agree the S198 election.
- Residential properties are excluded, except in special cases like furnished holiday lets.

2.5 Full Expensing

'Full Expensing' is a significant and valuable capital allowance designed to boost business investment. It allows companies to deduct the full cost of certain qualifying assets from their taxable profits in the year of purchase.

What is 'Full Expensing'?

'Full Expensing' is a 100% first-year allowance. This means that instead of claiming tax relief on an asset gradually over time (using Writing Down Allowances), a company can deduct the entire cost in the same year the expenditure is incurred. This provides immediate, substantial tax relief and significantly improves a company's cash flow.

Originally introduced as a temporary measure in 2023, the government's Autumn Statement in November of that year made the policy permanent, providing long-term certainty for businesses planning large-scale investments.

Who can claim it?

Unlike the Annual Investment Allowance (AIA), which is available to all businesses, 'Full Expensing' is only available to companies subject to Corporation Tax.

This means sole traders and partnerships cannot use this specific relief, though they can still benefit from the AIA and other allowances.

Did you know?

There is no time limit for historical claims: Unlike many other forms of tax relief, there is no deadline for making a claim for Capital Allowances. As long as you still own the asset and it is being used in the business, you claim for expenditure you incurred years or even decades ago by amending previous tax returns.

2.5 Full Expensing *(cont)*

What Expenditure Qualifies?

'Full Expensing' applies to most new and unused "main rate" plant and machinery.

This is a broad category that includes:

- ☑ **Office equipment:** Computers, desks, chairs, and printers.
- ☑ **Industrial machinery:** Manufacturing equipment, tools, and production lines.
- ☑ **Commercial vehicles:** Lorries and vans.
- ☑ **Some fixtures:** Such as office furniture and fitted equipment.

There are some important exclusions to be aware of:

- ☒ **Used or second-hand assets:** These do not qualify for 'Full Expensing' but can still be claimed under the AIA.
- ☒ **Cars:** Business cars are generally excluded, although specific allowances exist for zero-emission vehicles.
- ☒ **Assets bought for leasing:** The relief does not usually apply to assets that are bought to be leased out to others.
- ☒ **'Special rate' assets:** Integral features of buildings (like heating, lifts, and electrical systems) do not qualify for 100% 'Full Expensing'. Instead, a separate 50% first-year allowance is available for these assets, with the remaining balance subject to the lower 6% Writing Down Allowance.

How it Works in Practice

The key benefit of 'Full Expensing' is that there is no limit on the amount you can claim. For a company making a large investment, this is a much more powerful relief than the £1 million cap on the AIA.

» **For example,** if a company has a taxable profit of £5 million and invests £3 million in new machinery, they can deduct the entire £3 million from their profits, reducing their taxable profit to £2 million. This provides a significant in-year tax saving.

The 'Balancing Charge' on Disposal

A crucial part of 'Full Expensing' is the 'balancing charge' on disposal. If a company sells an asset on which they have claimed 'Full Expensing,' they must add 100% of the sale proceeds back to their taxable profits in the year of sale. This effectively claws back the upfront tax benefit, ensuring the business gets relief only for the net cost of the asset.

3. The Process for Claiming

The steps to claim Capital Allowances are straightforward in principle but can be complex in practice:

1. Identify Qualifying Expenditure:
This can include obvious items like vehicles and computers, but also less visible assets, particularly in commercial properties. Fixtures and fittings such as electrical systems, heating, ventilation, plumbing, and fire safety systems can all qualify.

2. Gather Documentation:
Keep detailed records, including invoices, contracts, and other supporting financial documents.

3. Calculate the Allowance:
Apply the correct rates and rules depending on the type of asset and the relevant pool or scheme.

4. Claim Through Your Tax Return:
For companies, Capital Allowances are claimed in the Corporation Tax return. Sole traders and partnerships claim them in the self-assessment tax return. Note that Full Expensing is available only to companies, whereas AIA and WDAs are available to all businesses.

4. The Benefits for Businesses

Correctly claiming Capital Allowances provides significant advantages:

REDUCED TAX BILL	By accelerating tax relief through the AIA or Full Expensing, businesses gain quicker access to capital.
IMPROVED CASH FLOW	These allowances incentivise businesses to invest in new equipment, technology, and commercial property, which boosts productivity and growth.
BALANCING ADJUSTMENTS	When assets are sold, businesses may face a balancing charge or allowance to ensure the correct amount of tax relief is given over the asset's life. These adjustments most often apply to single-asset pools (such as cars) or where AIA or first-year allowances have been claimed.

Did you know?

It's not just for new businesses: Many business owners think you can only claim allowances on assets you've just bought. This is not true. If you buy a second-hand commercial building, you can often claim Capital Allowances on all the qualifying fixtures and fittings that the previous owner installed, such as wiring, plumbing, and air conditioning, even if they were installed decades ago.

5. The Importance of Using a Specialist

While it is possible to handle Capital Allowances independently, engaging a specialist can deliver significant benefits:

» **Identifying Hidden Value:** Specialists can identify qualifying assets that business owners may overlook. A detailed survey of a commercial property, for example, may uncover allowances for plumbing, wiring, heating, or security systems worth substantial amounts.

» **Maximising the Claim:** Specialists have detailed, up-to-date knowledge of complex legislation, ensuring claims are accurate and fully optimised.

» **Risk Mitigation:** With HMRC increasingly scrutinising claims, a specialist ensures compliance and robust supporting documentation, reducing the risk of enquiry or penalties.

» **Saving Time and Resources:** Outsourcing this complex area frees up valuable internal resources, allowing business owners to focus on core operations.

Did you know?

Capital Allowances don't always reduce your Capital Gains Tax:

A common misconception is that claiming Capital Allowances on an asset will increase your Capital Gains Tax (CGT) bill when you sell it. This is generally not the case for most plant and machinery.

However, the **Structures and Buildings Allowance (SBA)** is an exception, as the allowances you claim do reduce your base cost for CGT purposes when you sell the property. This is a crucial distinction that can often be overlooked.

The legislation specifically states that SBA does not affect the base cost of the property for CGT purposes. Instead, when the property is sold, any buyer simply takes over the written down SBA balance (i.e. they inherit the relief going forward), and the seller does not have a balancing adjustment or clawback.

HMRC guidance confirms this:

- The base cost for CGT remains what you actually paid, regardless of SBA claimed.
- The SBA claimed just gives you income tax or corporation tax relief during ownership; it doesn't feed into the CGT calculation on disposal.

So, if you sell a property on which you've claimed SBA, your CGT base cost is not reduced, and there is no clawback of the relief already claimed.

Conclusion

Capital Allowances are more than just a tax relief mechanism; they are a powerful financial tool that can improve cash flow, reduce tax burdens, and support long-term business investment and growth.

Given the complexity of the rules and the risk of missing valuable opportunities, working with a specialist is not only a wise choice but often **a highly rewarding one.**

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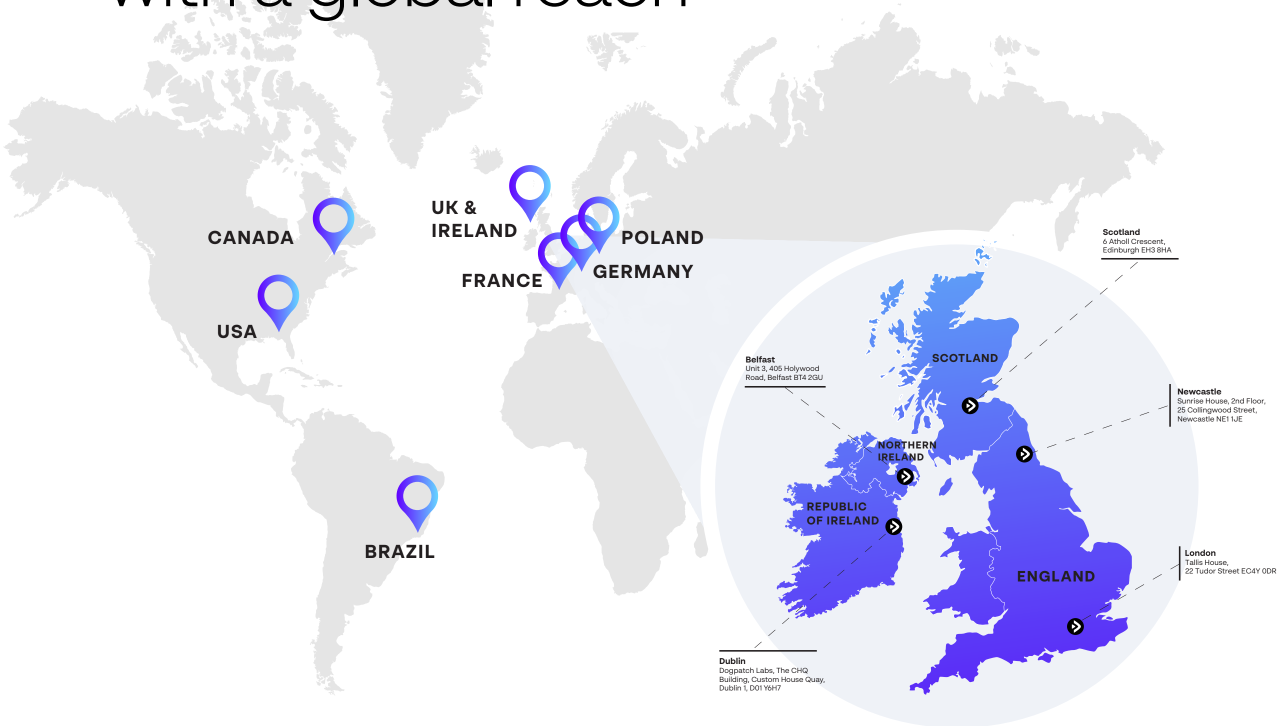

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