

# Introduction

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UK taxation rules distinguish between revenue expenditure and capital expenditure. Allowable revenue expenditure is deductible in full in computing taxable profits. Capital expenditure cannot normally be deducted in this way, and the depreciation charged in the accounts is not an allowable expense for tax purposes. Instead, many types of capital expenditure qualify for capital allowances, which in effect provide a standard measure of depreciation. This section gives an overview of the tax allowances for capital expenditure and the rules for claiming them.

## Capital allowances in general

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The different types of capital allowances each have their own rules and rates.

### Types of allowances

Capital allowances can be claimed for expenditure on:

- Plant and machinery (P&M).
- Industrial buildings (IBAs).
- Agricultural buildings and works (ABAs).
- Flat conversion (FCAs).
- Renovation of business premises in disadvantaged areas.
- Research and development (R&D).
- Patent rights.
- Know-how.
- Mineral extraction (MEAs).
- Cemeteries and crematoria.
- Dredging.

The most commonly met are the plant and machinery allowances. IBAs and ABAs are being phased out. Companies, but not individuals and partnerships, can get tax relief for purchases of intellectual property, goodwill and other intangible assets. The relief is only available for purchases after 31 March 2002. The relief is based on the amortisation shown in the accounts or a fixed 4% a year. It is not a capital allowance, so is not included in this section, but further details can be found in the separate topic 'Corporation tax'.

### Who can claim?

- Capital allowances can be claimed by:
- Companies.
- Sole traders and trading partnerships.
- Landlords.
- Employees, in some circumstances.

## How allowances are given

Allowances are normally given as a deduction in calculating trading profits or the profits of a property letting business. They are given in respect of a 'chargeable period', which for a company is its accounting period, and for sole traders and partnerships is a 'period of account'.

### Companies

- Capital allowances for expenditure incurred for trading purposes are given as a deduction in computing trading profits or losses.
- Allowances for capital expenditure in a property letting business are given as a deduction in computing property letting profits in the same way as for a trade.
- Investment companies can claim capital allowances on machinery and plant used for the management of their business. Allowances are deducted from income for that accounting period and any excess allowances become management expenses that can be offset against total profits for the same period or carried forward as excess management expenses to future periods.
- Capital allowance claims must be included in the self-assessment return for the relevant accounting period, and the amount of the claim must be quantified when the claim is made. The claim may be amended or withdrawn only by submitting an amended return within the normal self-assessment time limits.

### Sole traders and partnerships

- Capital allowances are given to sole traders and trading partnerships in a similar way as to companies.
- Capital allowances given against trading profits are calculated by reference to a 'period of account', which is normally the period for which the accounts are made up.
- Allowances must be claimed in the self-assessment return due by 31 January following the end of the relevant tax year if submitted online and by the previous 31 October if submitted on paper. A claim can be amended by 31 January following the online due date. In exceptional circumstances, a supplementary claim may be made within four years of the end of the tax year to which it relates, i.e. if the claim relates to the tax year 2010/11, a supplementary claim can be made before 6 April 2015.

### Landlords

- Landlords can claim capital allowances on plant and machinery used in the letting business, except that no allowances are normally available on items used in residential property.
- Allowances are given as a deduction in computing the profit from the property letting business.

### Employees

Capital allowances may be available where employees need to use privately owned assets in their employment. However, employees cannot claim capital allowances on cars, motorbikes or bicycles, but can only claim statutory mileage allowances for business travel.

## Date expenditure is incurred

It is often important to determine when capital expenditure is incurred.

- Allowances can generally be claimed for a chargeable period only if the expenditure was incurred in that period or a previous period.
- The rate at which an allowance is granted may change by reference to the date the expenditure was incurred.

- Generally, expenditure is treated as incurred on the date on which the obligation to pay that amount becomes unconditional, that is, the date that title passes, even though payment might not be due until a later date.
- The rule is modified in some circumstances.
  - If more than four months' credit is allowed, the expenditure is not treated as incurred until the date of payment.
  - If payment dates are artificially brought forward to claim allowances in an earlier chargeable period, the expenditure is treated as incurred only when payment actually becomes due.
  - In some circumstances, a person who has had an asset built to order can treat the expenditure as incurred in the previous chargeable period. This is allowed where the asset becomes the property of the buyer in the previous chargeable period, but the obligation to pay only becomes unconditional following the issue of an architect's or engineer's certificate, which is not issued until the first month of the following chargeable period.
  - With hire purchase and lease purchase agreements, the full capital cost is treated as incurred in the chargeable period in which the asset is first brought into use in the business. Where the asset is not brought into use until a later period, only capital payments actually made qualify for allowances.
  - Capital expenditure incurred before trade begins is treated as occurring on the first day's trading, so any allowances available are given in the first chargeable period of the business. However, the actual date of expenditure determines the amount of any allowance that is due.

## **Other points**

### **Partial claims**

It is not necessary to claim the maximum capital allowances available. A partial claim or disclaimer will postpone the benefit of capital allowances to future years and might help in tax planning. For example, a full claim might reduce the taxable income below the level of the individual's personal allowance, so some of that allowance is wasted.

### **Grants and subsidies**

Capital expenditure covered by grants and subsidies does not normally qualify for capital allowances.

## **Plant and machinery (P&M)**

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The P&M allowance is the most common allowance and the one that gives the most difficulty in practice.

- Businesses can claim the annual investment allowance (AIA) in the period when expenditure is incurred. This gives 100% tax relief on up to £100,000 of expenditure in a 12-month period (see the separate topic 'Capital allowances'). From 1 or 6 April 2012, the annual limit is reduced to £25,000.
- Where expenditure on general plant and machinery is more than £100,000, businesses can claim the main rate of writing-down allowance (WDA) on the balance, which is currently 20% a year balance. The writing-down allowance is due on most plant and machinery in the period when expenditure is incurred, and also in succeeding periods calculated on the reducing balance basis. From 1 or 6 April 2012, the main rate of WDA is reduced to 18%.

- The special rate of WDA is currently 10%, and it applies to long-life assets, integral features of a building, thermal insulation and motor cars with carbon dioxide (CO<sub>2</sub>) emissions of more than 160g/km bought after 31 March 2009. From 1 or 6 April 2012, this special rate is reduced to 8%.
- There are a few first-year allowances of 100% for some kinds of expenditure.

All these allowances are explained in more detail below.

## Qualifying expenditure

Allowances are given for capital expenditure that a trader incurs on plant or machinery wholly and exclusively for the trade. P&M capital allowances can also be given for some other activities, such as a property business or leasing otherwise than in the course of a trade. The activities (including trades) for which P&M allowances are available are known as 'qualifying activities'.

- The taxpayer must own the plant or machinery at some time during the period for which capital allowances are claimed, but it does not necessarily have to be brought into use in that period.
- Where an asset is partly used for non-business purposes, allowances can be claimed only on the proportion of the expenditure relating to business use.

## What is plant?

Generally, the words 'machinery' and 'plant' are not defined in tax law, and only a few assets are specifically included as plant and machinery. The term 'machinery' does not normally cause problems, but the term 'plant' has caused many difficulties.

An early court decision defined plant as including:

“whatever apparatus is used by a businessman for carrying on his business – not his stock in trade which he buys or makes for sale – but all his goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business”.

The basic characteristics of plant are that:

- It must have some degree of durability.
- It must have a function, which can be active or passive, and which is helpful to the particular business.
- Where the plant forms part of the premises or setting in which the business is carried on, it will not qualify as plant and machinery unless it has an additional function beyond being part of the setting. For example, the courts have held that ordinary lighting is not plant, but specialist lighting designed to attract customers or provide 'atmosphere' where relevant to the trade can qualify (ordinary lighting is now a designated integral feature, see the separate topic 'Capital allowances' below). Floor, carpet and wall tiles and internal partitions designed to remain in place permanently are generally not plant.
- Any expenditure on a building should always be analysed carefully to identify assets that qualify for capital allowances.
- Some expenditure specifically qualifies for capital allowances:
  - Expenditure on computer software, although a revenue deduction can often be claimed instead.
  - Expenditure on thermal insulation, which qualifies for the special rate of WDA of 10% per year.

- Some expenditure on sports grounds to obtain a safety certificate. The claim is not reduced if the Football Trust pays some of the cost.
- Expenditure on personal security assets where the individual at risk is in danger because of their occupation.
- The cost of installing plant or machinery also qualifies, as does the cost of demolition of plant and machinery.

## **Integral features of a building**

From 1 April 2008 (companies) or 6 April 2008 (unincorporated businesses), expenditure on certain assets are designated as integral features of a building.

- These integral feature assets qualify for the AIA.
- Any expenditure on integral features not included in an AIA claim is taken to the special rate pool, and the WDA of 10% can be claimed. From 1 April 2012 (companies) and 6 April 2012 (unincorporated businesses) this special rate WDA is reduced to 8%.
- The designated integral features are:
  - 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.
- Plant and machinery not on the designated integral features list, but fixed to the building, will normally qualify for the main rate of WDA at 20%. Examples are bathroom and kitchen equipment.
- Where a business repairs an integral feature, and the total cost of those repairs in any 12-month period is more than 50% of the cost of replacing it in full, the repair cost is treated as capital expenditure. This capital expenditure is treated as a new integral feature and the allowances are due as described above. Without this rule, such repair expenditure would be deductible in full as a revenue cost.
- Integral features cannot be treated as short-life assets to speed up the relief.

## **Long-life assets**

Expenditure on plant and machinery with a useful economic life of 25 years or more qualifies for the special rate WDA of 10% (reduced to 8% from April 2012). The useful economic life starts at first use of the asset, not just use by the current owner.

- The rules only apply in a period in which the business spends more than £100,000 on long-life assets.
- This limit is reduced for accounting periods of less than 12 months, and for companies with associated companies.
- The following assets are not treated as long-life assets:

- Motor cars.
- Seagoing ships and railway assets, for expenditure up to 31 December 2010 only.
- Plant and machinery which is a fixture in, or is provided for use in, a dwelling house, retail shop, showroom, hotel or office.

## **Fixtures under leases**

- Fixtures that are bought by the tenant of a building and become a fixture of that building are owned in law by the owner of the building.

For capital allowance purposes, the fixtures may be treated as owned by the tenant. A landlord and tenant who share the expenditure can claim allowances on their respective shares.

Where someone entitled to capital allowances on fixtures grants a lease and the lessee pays a capital sum for the fixtures, the fixtures are treated as owned by the lessee if the two parties so elect. The election must be made within two years of the grant of the lease.

## **Equipment leasing**

The rule that a fixture may be treated as owned by the tenant does not apply where the fixture is leased by a lessor of equipment. The lessor can claim the allowances, provided the lessor and lessee make a joint election and the lessee is within the charge to UK tax.

## **Purchase of an interest in land**

Where someone buys an interest in land, such as a freehold or leasehold, and pays for a fixture that is already in place, ownership in the fixture passes to the buyer. Capital allowances on these fixtures are restricted to their original cost.

- The buyer and the seller of the building can normally make a joint election to determine how much of the sale price relates to fixtures.
- This figure cannot be more than the lower of:
  - The original cost of the fixtures, and
  - The total sale price of the building.
- The election must be made within two years of the disposal, and must specify the exact amount apportioned to fixtures.
- Anti-avoidance provisions prevent the acceleration of allowances for the seller by the disposal of fixtures at artificially low prices. In effect, these provisions impose a lower limit to the amount of the sale price that relates to fixtures.
- Where different types of capital allowance claims are available for fixtures, for example, as plant and machinery or as a part of an industrial building (up to 2011), the buyer of the fixtures is bound by the first claimant's choice of allowances.

## **Annual investment allowance (AIA)**

Businesses can get 100% tax relief in the year of purchase on the first £100,000 of expenditure on most types of equipment by claiming the AIA.

- The allowance is available for expenditure from 1 April 2008 for companies and from 6 April 2008 for individuals and partnerships.
- For expenditure incurred between 1 April 2008 and before 1 April 2010 (in the case of companies) or between 6 April 2008 and 5 April 2010 (for others), the AIA was available for the first £50,000 of expenditure only. Taxpayers with chargeable periods straddling the

1/6 April 2010 dates will be treated, for the purpose of calculating the AIA, as having two chargeable periods – the first ending on 31 March/5 April (for which the maximum AIA will be the appropriate proportion of £50,000) and the second beginning on 1/6 April (for which the maximum AIA will be the appropriate proportion of £100,000). From 1 April 2012 for companies or 6 April 2012 for others, the maximum annual allowance becomes £25,000 and a similar calculation will have to be performed for straddling periods.

- Designated integral features of a building, long-life assets (see above) and equipment for leasing can all qualify for the AIA.
- The main exclusion is motor cars.
- The allowance is proportionately increased or reduced for chargeable periods that are longer or shorter than 12 months.
- The AIA cannot be claimed in the period in which the business is permanently discontinued.
- Companies that form a group are entitled to only one AIA between them.
- Where companies do not form a group but are controlled by the same person or persons, they will share the AIA if they are 'related', which means sharing business premises or having similar activities.
- Similarly, where an individual or individuals control more than one unincorporated business and they are 'related', the businesses must share one AIA.
- There is no sharing of AIA if an individual or group of individuals controls a company and an unincorporated business. The corporation tax and income tax allowances are entirely separate.
- Partnerships that include one or more companies as members cannot claim the AIA.
- Trusts that carry on a trade cannot claim the AIA.

## **Writing down allowances (WDAs)**

Expenditure on general plant and machinery in excess of the AIA limit is 'pooled'.

This main rate pool will also include:

- The balance of expenditure incurred before the introduction of the AIA that qualified for allowances of less than 100% at the time.
- The balance of expenditure brought forward after a claim for an FYA.
- Expenditure on motor cars with CO<sub>2</sub> emissions of 160g/km or less bought after 31 March 2009 (companies) or 5 April 2009 (unincorporated businesses). Cars do not qualify for the AIA.
- The balance of expenditure brought forward on cars costing £12,000 or less bought before 1 or 6 April 2009.

The main rate WDA is then 20% of:

- The unrelieved expenditure brought forward from the previous period, plus
- Expenditure incurred in the current period, less
- The 'disposal value' of items sold during the period.

### Example 26.1 – WDA calculation

Rachel has unrelieved expenditure of £5,000 brought forward. In the present period, she sold equipment for £2,000 and bought a motor car with CO<sub>2</sub> emissions of 160g/km for £13,000.

Her WDA at the main rate is calculated as follows:

	£
Unrelieved expenditure brought forward	5,000
Purchase of car	13,000
Disposals	(2,000)
	<hr/>
	16,000
WDA 20%	3,200
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Unrelieved expenditure carried forward	12,800

### Special rate pool

Expenditure that qualifies for capital allowances at 10% is pooled separately in a 'special rate' pool. This pool consists of expenditure on:

- Integral features of a building.
- Thermal insulation.
- Long-life assets.
- Motor cars with CO<sub>2</sub> emissions of more than 160g/km bought after 31 March 2009.

As with the general pool, allowances are calculated on the balance of expenditure in the pool after adding expenditure on additions and deducting the disposal value of items sold.

The 10% rate becomes 8% for expenditure incurred after 31 March 2012 (companies) or 5 April 2012 (other qualifying taxpayers).

### Small pool balances

Businesses can write off a pool balance of £1,000 or less in full, where the accounting period started on or after 1 April 2008 (companies), or 6 April 2008 (unincorporated businesses). It is not possible to write off such balances for assets that are not in the main or special rate pools.

### Assets that are not pooled

Some assets must be kept separate in the capital allowances calculation.

They are:

- Cars costing over £12,000 bought before 1 April 2009 (companies) or 6 April 2009 (unincorporated businesses), except for low emission cars that qualify for an FYA of 100% (see the separate topic 'Capital allowances').
- Assets partly used outside the business.
- Assets let other than in the course of a trade (which are pooled separately).
- Short-life assets.

- Assets on which an FYA is claimed. These only join the pool in the following accounting period.
- Ships, unless an election for pooling is made.

### **Periods other than 12 months**

- The WDA is proportionately reduced for periods shorter than 12 months. For example, the main rate WDA for an eight-month period would be 8/12ths of 20%.
- For sole traders and partnerships, the WDA is proportionately increased for periods of more than 12 months. Companies' accounting periods for tax purposes can never be longer than 12 months.
- These adjustments apply to pooled and non-pooled expenditure.

### **Disposals**

If a business disposes of an item from the pool, the disposal value is deducted from the balance of the pool. If, exceptionally, the disposal value is more than the original cost of the asset, only the original cost is deducted. The excess may be treated as a capital gain. The disposal value is:

- The net proceeds of sale, together with any insurance or other compensation received that might have affected the sale price.
- The market value if the asset is sold for lower than it would have fetched in the open market, unless:
  - The buyer will qualify for capital allowances.
  - The asset is sold to an employee, who is taxed on the benefit of receiving the asset at a reduced price.
- The insurance proceeds in the event of the permanent loss or destruction of the item.

If the disposal value is more than the pool balance, the excess is a 'balancing charge' and this amount is added to the trading profit for the year.

### **Final period of a business**

WDAs are not claimed in the final period of the business. Instead, the disposal values of all the assets sold in that period and the market values of the assets still held at the date of cessation are deducted from the balance of unrelieved expenditure. The result is either a balancing charge to be added to the profits, or a balancing allowance to be deducted from the profits. There can only be a balancing allowance in the main and special rate pools when the trade ends. In a continuing trade, even where all the assets are disposed of, WDAs will continue to be given on any unrelieved expenditure.

### **Motor cars**

Expenditure on motor cars bought after 31 March 2009 (companies) or 5 April 2009 (unincorporated businesses) qualifies for WDA at a rate that depends on the car's CO<sub>2</sub> emissions.

- Expenditure on cars with CO<sub>2</sub> emissions above 160g/km is placed in the special rate pool and attracts WDA at 10%.
- Expenditure on cars with CO<sub>2</sub> emissions of 160g/km and below is placed in the main pool and attracts WDA at 20%.
- Expenditure on new cars with CO<sub>2</sub> emissions of 110g/km and below qualifies for a 100% FYA (see the separate topic 'Capital allowances').

- There is no longer any restriction on WDA for cars that cost more than £12,000.
- Expenditure incurred between 1 April 2010 (companies) or 6 April 2010 (others) and 31 March 2015 (companies) or 5 April 2015 (others) on zero-emission goods vehicles qualifies for a 100% FYA.
- Cars do not qualify for the AIA, but goods vehicles do.

### **Cars bought before 1 or 6 April 2009**

Each motor car costing more than £12,000 (with the exception of low-emission cars that qualify for a 100% FYA) was kept separate from the expenditure pools. The WDA that can be claimed on such a car is the lower of £3,000 and 20% of the unrelieved expenditure. This is reduced or increased proportionately on the same basis as the general pool where the period is not 12 months. For example, the maximum WDA that can be claimed in a nine-month accounting period on a car costing £20,000 is £2,250 (9/12ths of £3,000). These rules will continue for a transitional period of five years, ending on 31 March/5 April 2014.

### **Private use**

Private use of any motor car by a sole trader or a partner in a partnership restricts the allowances that can be claimed to the proportion of business use. Such cars must be kept in a separate capital allowance pool. The same rule applies to any other assets with non-business use. There is no restriction of a company's capital allowances where an asset is used privately by a director or employee. Instead, the director or employee is charged income tax on the benefit in kind.

### **Short-life assets**

- Capital allowances can be accelerated on assets that depreciate rapidly, such as computers and other high-tech assets.
  - Taxpayers must make a written election (which is irrevocable) for any plant or machinery to be a short-life asset. For sole traders and partnerships, the time limit is one year after the 31 January following the tax year in which the period of account in which the expenditure is incurred ends. For companies, the deadline is two years after the end of the accounting period in which the expenditure is incurred.
  - The election must specify the asset concerned, its cost and the date the expenditure was incurred.
- A short-life asset is not pooled. Allowances are given on the individual asset and a balancing allowance or charge arises when the asset is sold or scrapped. This means that the full cost of the asset is allowed over the period of ownership. If the asset is still held four years after the end of the accounting period in which it was acquired, it is transferred into the main pool in the following period.
- Where a large number of small, similar assets have been bought in a period, each period's acquisitions are kept in a separate pool. If the assets cannot be separately identified, the average actual life of the assets is agreed with HM Revenue & Customs (HMRC) and the unrelieved expense in the pool at the end of that lifetime is given as a balancing allowance on the assumption that they have been scrapped. If the assets can be identified, then on the sale of assets out of the pool, a proportion of the pool expenditure is treated as relating to them when calculating the balancing adjustment.
- The following assets cannot qualify for short-life treatment:
  - Motor cars.
  - Ships.

- Assets where there is an element of private use.
- Some leased assets.

## **First-year allowances of 100%**

FYAs of 100% can be claimed in some circumstances.

- If expenditure qualifies for an FYA, the allowance is given in the chargeable period of purchase and the expenditure does not enter the calculation of WDA.
- If the full 100% allowance is not claimed, the balance of expenditure enters the expenditure pool for the following period.
- It is possible to claim less than the maximum FYA, for example, to prevent an individual's personal allowances from being wasted.
- Expenditure that qualifies for FYAs does not count towards the AIA limit.

### **Low-emission cars**

Any business can claim a 100% FYA on a new car that meets the following conditions:

- The car is bought new.
- The car either:
  - Emits not more than 110g/km of CO<sub>2</sub>, or
  - Is electrically propelled.

If a sole trader or partner in a partnership uses the car privately as well as for business, only the business proportion will qualify for the FYA. If the full 100% allowance is not claimed, the balance of the cost will go into the expenditure pool for the next accounting period. The car may be used in the business or for leasing. The sale proceeds of a low emission car are added to the general pool in the usual way.

The FYA on low-emission cars will be withdrawn after 31 March 2013.

### **Energy-saving and environmentally beneficial plant and machinery**

Businesses can claim a 100% FYA on expenditure on designated energy-saving or environmentally beneficial plant or machinery.

- Cars, ships and railway assets cannot qualify.
- The equipment must be new, not second-hand.
- Energy-saving equipment must appear on the Energy Technology Product List held by the Department of the Environment, Food and Rural Affairs (DEFRA). Details appear on the enhanced capital allowances website at [www.eca.gov.uk](http://www.eca.gov.uk).
- Environmentally beneficial plant and machinery must appear on a Water Technology List published by DEFRA.

### **Ships**

Each ship is normally kept in a separate pool of its own and WDAs are given at the main rate of 20%.

- When the ship is disposed of, the balancing charge or allowance is deducted from or added to the main pool of plant and machinery expenditure. Alternatively, a balancing charge can

be deferred and set against expenditure on ships acquired within the following six years. The ships must be seagoing, with a gross tonnage in excess of 100 tons.

- A ship owner can elect:
  - To postpone all or part of the WDA until a later period.
  - For ships to be included in the main pool of expenditure, in which case a balancing charge cannot be deferred.
  - To transfer any expenditure from the single ship pool to the main pool.

## **Successions to a trade**

Where there is a succession to a trade and the buyer and seller are connected, they can normally jointly elect to transfer plant and machinery at its tax written-down value. The seller therefore avoids a balancing charge on the sale.

Both buyer and seller must be subject to UK tax, and the election must be made within two years of the succession.

The definition of 'connected persons' is complex, but it covers transfers between close family members, the incorporation of a business and transfers between group companies.

## **Anti-avoidance**

The law provides various rules intended to prevent taxpayers from obtaining or accelerating capital allowances by 'artificial' means. Areas covered include transactions between connected persons, leasing, and sale and leaseback arrangements.

- Allowances are restricted on capital expenditure on plant or machinery for leasing under a 'finance lease'. A proportion of the allowance is given by reference to the proportion of the accounting period that falls after the time the expenditure was incurred. For example, only one-quarter of the allowance is given where expenditure is incurred three months before the end of a 12-month period.
- In a sale and leaseback transaction, the disposal value to the seller and the amount on which the lessor can claim allowances may be limited to the market value of the asset or, in some cases, the notional written-down value. In some wholly commercial circumstances, the parties can elect in writing for the restriction not to operate.
- For leases finalised before 1 April 2006, WDAs may be reduced to the special rate of 10%, or may not be available at all, on leases to non-UK residents of assets used outside the UK. This restriction does not apply to short-term leasing or to the leasing of ships, aircraft or transport containers.

In the case of most types of longer-term finance leases, known as 'long funding leases', the primary entitlement to capital allowances is with the lessee and not the lessor.

- Assets used for business entertainment do not qualify for capital allowances.
- Where companies have entered into arrangements, the main purpose, or one of the main purposes of which is to acquire an interest in 'an excess of allowances', i.e. where the tax written down value of assets is greater than the balance sheet value as a consequence of the previous owner's disclaiming capital allowances. The legislation restricts the relief available for the 'excess of allowances'.

## **Industrial buildings allowances (IBAs)**

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IBAs were phased out from 2008/09, and withdrawn completely from April 2011. This subsection outlines the rules that applied to April 2011 and the phasing out process.

A WDA of 1% is available for 2010/11 for construction expenditure incurred on a qualifying industrial building or structure, where the person incurring the expenditure uses it for a qualifying purpose. Enhancement expenditure also qualifies for WDAs. In some circumstances, the lessee of an industrial building can claim IBAs.

- The WDA is calculated on a straight-line basis. The allowance was 4% up to 31 March 2008 for corporation tax and up to 5 April 2008 for income tax. The effect was that expenditure on an industrial building was written off over 25 years.
- The rate of WDA was 3% in 2008/09 and 2% in 2009/10, 1% in 2010/11 and nil thereafter.
- The person with the 'relevant interest' in the building can claim the allowance. This is the person who incurs or is treated as incurring the original construction expenditure.
- The WDA is proportionately reduced or increased for periods of less than or more than 12 months.
- The building must be in industrial use, or temporary disuse, at the end of the accounting period.
- If an industrial building is in use for a non-industrial purpose at the end of the period, no WDA is given for that period. Instead, a notional WDA is deducted from the unrelieved expenditure.
- If a building has a lease of more than 50 years, IBAs may be claimed by the lessee rather than the lessor, as long as a joint written election is made within two years of the start of the lease.

### **Definition of an industrial building or structure**

To qualify for IBAs, the building or structure must be in use for:

- A trade carried on in a mill, factory or other similar premises.
- An undertaking involving transport, docks, inland navigation, water, electricity, hydraulic power, tunnels, bridges or toll roads.
- A trade that consists of the manufacture of goods or materials, or the subjection of goods or materials to any process. This includes maintaining or repairing any goods or materials, but not as part of a retail or non-qualifying trade.
- A trade that consists of the storage of:
  - Raw materials for manufacture.
  - Goods to be processed in the course of a trade.
  - Goods that have been manufactured or processed but not yet delivered to a buyer.
  - Goods on their arrival in the UK from abroad.
- A trade that consists of working any mine, oil well or foreign plantation.
- A trade carried on by an agricultural contractor.
- A trade that consists of catching fish or shellfish.
- The welfare of workers employed in a qualifying trade or undertaking, for example, a canteen or social club.

A structure is basically any permanent object sitting on land that is more than earthworks, and can include roads and car parks in some cases.

Buildings abroad do not qualify unless the trade carried on in them is taxed in the UK.

### **Inclusions**

The following are also treated as industrial buildings:

- Sports pavilions provided for the welfare of the employees, whether or not the trade is a qualifying one.
- Some hotels – see the separate topic ‘Capital allowances’.

### **Exclusions**

The following are specifically excluded:

- Dwelling houses.
- Non-qualifying hotels.
- Retail shops and buildings used for purposes ancillary to a retail trade.
- Showrooms.
- Offices.

Difficulties can arise over the definitions of an office and buildings used for purposes ancillary to a retail trade.

### **Qualifying expenditure**

The expenditure must be incurred on the construction of an industrial building or the industrial part of a building that is used for both industrial and non-industrial purposes. An addition or an improvement to an existing building can also qualify.

- No allowance is available for the cost of the land, although the cost of preparing, levelling, cutting or tunnelling the land is treated as building costs.
- IBAs are given on the whole cost of an industrial building that includes up to 25% (by reference to cost) of non-industrial parts, such as offices. Two sections of a building are part of the same building for this purpose if they are joined internally – a covered walkway is not enough.
- Businesses that are partially exempt for VAT might need to make adjustments under the Capital Goods Scheme for land and buildings. Additional VAT paid is treated as if it is qualifying expenditure incurred when the VAT is paid, and VAT refunds are treated as reductions of qualifying expenditure.

### **Balancing adjustments**

A balancing charge or allowance used to arise when an industrial building was sold during its tax life, irrespective of its use just before sale. Since 21 March 2007, a balancing adjustment can only be made where a sale is in pursuance of a relevant pre-commencement contract (see below) or the sale is of a building in an enterprise zone.

- A pre-commencement contract is an unconditional contract made in writing before 21 March 2007 that is not significantly varied after that date.
- Expenditure on the construction of certain commercial buildings in enterprise zones qualify for a 100% capital allowance.
- The tax life of a building begins on its first day of use. The tax life was 50 years for expenditure before 6 November 1962, and 25 years for expenditure after 5 November 1962.

- If the building is sold for more than its original cost, all the allowances given were clawed back by a balancing charge. The excess was taxed under the capital gains tax (CGT) rules.
- If the building had always been used as an industrial building and was sold for less than its original cost, the sale proceeds were compared with the balance of unrelieved expenditure in the IBA computation. If the sale proceeds were more, there was a balancing charge equal to the excess. If the sale proceeds were less, a balancing allowance was given instead.
- The calculations were adjusted if the building had had any non-industrial use and was sold for less than its original cost.
- The buyer was entitled to WDAs calculated under special rules over the remaining tax life of the building.
- On a sale from 21 March 2007 on which there is no balancing adjustment, the buyer is simply entitled to claim the IBAs that the seller would have been able to claim had the building not been sold.

## Hotels

Expenditure on the construction or extension of a qualifying hotel is eligible for IBAs.

- A qualifying hotel is one which:
  - Has accommodation in buildings of a permanent nature.
  - Is open for at least four months during April to October.
  - Has at least ten letting bedrooms available generally, and no bedroom may be used by the same individual for more than one month.
  - Offers sleeping accommodation that consists mainly of letting bedrooms.
  - Provides services for guests including breakfast and evening meals, bed-making and cleaning rooms.
- Buildings provided for the welfare of hotel employees are treated as part of the hotel. Where the hotel is run by an individual or partnership, accommodation for the proprietor and the proprietor's family qualifies only if it represents 25% or less of the cost.
- If a hotel no longer qualifies, it is treated as if it had been sold at market value two years after the date of non-qualification.

## Sales between connected persons

On a sale of an industrial building between connected persons, a joint election can be made for the sale price for IBA purposes to be the lower of:

- Market value.
- The unrelieved expenditure in the IBA computation.

An election normally avoids a balancing charge.

## Phasing out of IBAs

The allowance was finally phased out on 1 or 6 April 2011 (the earlier date applies for corporation tax purposes and the later date for income tax purposes).

## Agricultural land and buildings

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Like IBAs, ABAs were phased out between April 2008 to April 2011. This subsection outlines the rules that applied to 2010/11 and the phasing out process.

### Qualifying expenditure

The expenditure qualifying for ABAs is the cost of construction (excluding the cost of land) of:

- Farmhouses, up to a maximum of one-third.
- Farm or forestry buildings.
- Cottages.
- Fences or other works.

The expenditure is only allowed if it is incurred for husbandry or forestry on the agricultural land in question. Husbandry includes any method of intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption.

### The allowances

A WDA of 1% on a straight-line basis is given in 2010/11 to a person who has a 'major interest', basically a freehold or leasehold interest, and incurs qualifying expenditure.

- WDAs are given as a deduction in computing trading profits or letting income.
- WDAs start in the period in which the expenditure is incurred.
- If a building is sold before being used for a qualifying purpose, any allowances given are withdrawn.
- If the building is erected for a trader who does not use it but sells it on, the buyer can claim ABAs based on the lower of cost of construction and the price paid.

In 2008/09 the WDA was 3%, and in 2009/10 it was 2%.

### Disposal of agricultural buildings

A person who buys an agricultural building during its 25-year tax life is entitled to ABAs.

- The buyer must have the same interest in the property as the seller, so if the owner merely grants a lease, the tenant cannot claim any allowances.
- Proportionate allowances are given to the buyer and seller in the period of the sale. The new owner is then entitled to claim the same annual WDA that the seller was claiming throughout the remainder of the 25-year tax life.
- If the buyer and seller have different accounting dates, the total amount of WDA claimed in their periods of transfer will not equal the annual WDA. The difference is adjusted in the final year's ABA claim.
- Alternatively, where an unconditional contract was entered into in writing before 21 March 2007, the buyer and seller can make a joint written election to treat the disposal in the same way as for an industrial building. For sole traders and partnerships, the election must be made within one year of the 31 January following the tax year in which the period of account of disposal occurs. For companies, the deadline is two years after the end of the

accounting period. The election cannot be made if either the buyer or the seller is not liable to UK tax, nor if the intention was purely to increase the allowances available.

- Where agricultural property reverts to a landlord at the end of a lease or a new tenant fails to make a payment to the outgoing tenant for the qualifying assets, the unused allowances revert to the landlord.

## Flat conversion allowances (FCAs)

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A 100% FYA is available for expenditure on converting or renovating unused space, or space used only for storage, above commercial premises into self-contained flats for residential letting. The allowance is given against letting income.

### Qualifying expenditure

- Qualifying expenditure is the cost of:
  - Converting part of a qualifying building into a qualifying flat.
  - Renovating a flat in a qualifying building if the flat will be a qualifying flat.
  - Repairs to the building that are incidental to expenditure in the first two categories.
- The part of the building or flat being converted or renovated must have been unused or used only for storage throughout the year ending immediately before work began.
- No allowance is given for the costs of acquiring land, developing land adjoining the building, extending the building (except to provide an entrance to a qualifying flat) or providing furniture and equipment.

### Qualifying building

A building qualifies if all the following conditions are met:

- All or most of the ground floor must be authorised for business use within classes A1, A2, A3, B1 or D1(a) of the Town and Country Planning (Use Classes) Order 1987. This includes retail shops, food and drink, offices, medical or dental practices, and certain light industrial processes.
- The floors above the ground floor must have been intended for residential use originally.
- The building must not have more than four storeys above the ground floor.
- The construction of the building must have been completed before 1 January 1980.

### Qualifying flat

A flat in a qualifying building qualifies if the following conditions are met:

- It is suitable for letting as a dwelling.
- It is held for the purpose of short-term letting, which is defined as on a lease or for a term of up to five years.
- It must be accessible from the street without going through the business part of the building.
- It must not have more than four rooms, excluding any kitchen, bathroom or small hallway.

- It must not be a high-value flat or have been created or renovated as part of a scheme involving the creation or renovation of high-value flats.
- It must not be let to a person connected with the person who incurred the expenditure on its conversion or renovation.

A high-value flat is one for which the weekly rent that could reasonably be expected for the flat, assuming the flat is let furnished on a shorthold tenancy and the tenant does not have to make any other payments for it, would be not more than the following limits:

Number of rooms in flat	Greater London	Elsewhere
1 or 2	£350	£150
3	£425	£225
4	£480	£300

There is provision for these limits to be increased.

### The allowances

The initial allowance is 100% of the qualifying expenditure, given to the person who incurred the expenditure.

- The allowance is made for the period in which the expenditure is incurred.
- If all or part of the initial allowance is not claimed, a WDA of 25% of the qualifying expenditure is given for each chargeable period in which the person still owns the flat, up to the amount of the unclaimed balance of the expenditure.
- The allowance is given as a deduction in the letting income computation. Any unrelieved excess can be set against other income of the same or the following year.

### Disposals

A balancing charge, or occasionally an allowance, is made if certain events occur within seven years of the time when the flat was first suitable for letting as a dwelling. These events are:

- The person who incurred the expenditure sells their interest in the flat or grants a lease of more than 50 years in return for a capital sum.
- If the person who incurred the expenditure is a leaseholder and the lease comes to an end.
- The person who incurred the expenditure dies.
- The flat is demolished or destroyed, or ceases to be a qualifying flat, for example, if the expected rent increases beyond the specified limits.

The balancing charge is the excess of any proceeds from the event, e.g. sale or insurance proceeds, over the allowances claimed. If the proceeds are less than the allowances claimed, a balancing allowance is given. However, no balancing allowance is given where the sale proceeds are artificially reduced as a result of a tax avoidance scheme.

## Business premises renovation allowance

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A 100% FYA is available to individuals and companies that incur capital expenditure on bringing qualifying business premises back into business use. The allowances are made to the person who

incurred the expenditure, whether they own or lease the building. Expenditure made between 11 April 2007 and 10 April 2017 can qualify for the allowance.

## **Qualifying expenditure**

The expenditure must be on:

- The conversion of a qualifying building into qualifying business premises.
- The renovation of business premises.
- Repairs incidental to the conversion or renovation of the building, provided the expenditure is not deductible from profits as a trading expense.

The costs of acquiring land or of building an extension to a building (other than for access) will not qualify for the allowance.

## **Qualifying buildings and qualifying business premises**

A qualifying building is a building in a designated disadvantaged area (at the date of the start of the work) that has been vacant for at least a year and was last used for the purpose of a trade, profession or vocation or as offices. Disadvantaged areas are defined as the whole of Northern Ireland, and the areas specified as development areas by the Assisted Areas Order 2007.

After conversion or renovation, the building must be used, or be available and suitable for letting for use, for the purpose of a trade, profession or vocation or as offices. The following buildings are excluded from this scheme:

- Buildings used or available to be used as residential premises.
- Where the person holding the interest in the building carries on an excluded trade.
- Where the building is used wholly or partly for an excluded trade.

The following trades are excluded trades:

- Fisheries and aquaculture.
- Ship building.
- The coal industry.
- The steel industry.
- Synthetic fibres.
- The primary production of certain agricultural products.
- The manufacture or marketing of milk substitutes.

## **The allowances**

The person who has incurred the expenditure is entitled to an initial allowance of 100% of the qualifying expenditure in the period in which the expenditure was incurred. The allowance is withdrawn if at the time the premises come to be used, or available for letting, they are not qualifying business premises, or the person who claimed the allowance has sold the building.

If the full 100% has not been claimed, perhaps because the person incurring the expenditure did not have enough income and wanted to preserve other reliefs, a 25% WDA can be claimed. The allowance is 25% of the residue of expenditure after deducting the initial allowance. It is given on a reducing balance basis. No allowances are given for any expenditure for which the person incurring the expenditure has received a grant.

## Disposals

A balancing charge, or occasionally an allowance, is made if certain events occur within seven years of the time when the premises were first used, or suitable for letting, after the conversion or renovation. These events are:

- The person who incurred the expenditure sells their interest in the building or grants a lease of more than 50 years in return for a capital sum.
- If the person who incurred the expenditure is a leaseholder and the lease comes to an end.
- The person who incurred the expenditure dies.
- The building is demolished or destroyed, or ceases to be qualifying business premises.

The balancing charge is generally the excess of any proceeds from the event, e.g. sale or insurance proceeds, over the allowances claimed. If the proceeds are less than the allowances claimed, a balancing allowance is given.

## Research and development (R&D)

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R&D allowances, formerly known as scientific research allowances, are given for capital expenditure. A separate R&D tax relief exists for revenue expenditure.

### Qualifying expenditure

Capital expenditure on R&D carried out for an existing trade, or a trade that starts later, qualifies for a 100% allowance that is deducted from trading profits.

- R&D means activities treated as such under normal UK company accounting practice, subject to any Treasury regulations excluding or adding any activities within the definition. It includes oil and gas exploration and appraisal.
- The following expenditure does not qualify:
  - The cost of any land.
  - The cost of any residential dwelling, unless it forms less than 25% of the cost of a building used for R&D.

### Changes in ownership

If a qualifying asset no longer belongs to the trader, the disposal value is added to trading profits. The amount of the disposal value depends on the method of disposal:

- If the asset is sold, the disposal value is the greater of the sale proceeds and its market value.
- If the asset is destroyed, the disposal value is the amount of any insurance recovery or scrap value received, less the cost of demolition.
- Any other disposal is treated as taking place at its market value.

The disposal value cannot be more than the allowances given.

## Patent rights

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The term 'patent rights' means the right to do or authorise the doing of anything that would, but for that right, be an infringement of the patent.

Allowances for expenditure on patent rights are available to traders using them for a trade, and other taxpayers who receive taxable income from the use of those rights.

Companies cannot claim capital allowances for expenditure on patent rights incurred after 31 March 2002. Such expenditure is subject to the revised rules introduced from that date for intellectual property, goodwill and other intangible assets. Allowances continue to be given for periods after 31 March 2002 where the expenditure was incurred before 1 April 2002.

## **The allowances**

All relevant costs are included in a special 'patent rights pool', and a WDA of 25% on a reducing balance basis can be claimed in the same way as for plant and machinery – see the separate topic 'Capital allowances'.

## **Sale of patent rights**

The sale of part or all of the patent rights is treated in the same way as the sale of pooled plant and machinery. There will be a balancing allowance if all the patent rights are sold or the trade ends.

- If the sale proceeds are more than the original cost, the deduction from the pool is limited to the original cost.
- The excess over cost is taxed in equal instalments over the six years beginning in the year of sale.
- The taxpayer can elect to have the whole profit taxed in the year of sale.

## **Know-how**

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Know-how means any industrial information and techniques likely to help in manufacturing, mining, agriculture, forestry or fishing.

- The capital allowances rules are almost identical to those for patent rights, except that where the sale proceeds of know-how are more than the original cost, the full amount is deducted from the pool of unrelieved expenditure without restriction.
- If know-how is sold together with a trade, the proceeds are treated as a payment for goodwill. However, the buyer and seller can make a joint election, in which case the buyer will qualify for capital allowances in the normal way, and the seller will be taxed on the proceeds.
- No allowances are available on commercial know-how, for example, know-how related to marketing, distribution or packaging.
- Companies cannot claim capital allowances on know-how for expenditure incurred after 31 March 2002, as this expenditure is now dealt with under the corporate tax rules for intellectual property. Allowances continue to be given for periods after 31 March 2002 where the expenditure was incurred before 1 April 2002.

## **Miscellaneous other allowances**

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Expenditure on several other items might also qualify for capital allowances.

### **Mineral extraction allowances (MEAs)**

Qualifying capital expenditure includes searching for and testing mineral deposits and winning access to them, the cost of acquiring the mineral deposits, expenditure on the construction of

works for winning the minerals, and restoration expenditure incurred in the three years after the end of the trade. The definition of mineral deposits includes geothermal energy.

A WDA of 25% is available, similar to the WDA for plant and machinery. However, the WDA is only 10% for:

- The acquisition of minerals or rights over them.
- Pre-trading exploration expenditure.

## **Cemeteries and crematoria**

The cost of land used for graves during a period is treated as a trading expense. The cost of other land and any buildings likely to be of little value when the cemetery is full is also proportionately written off. For crematoria, memorial garden plots take the place of grave spaces.

## **Dredging**

This includes capital expenditure on dredging by a trader whose business involves maintaining or improving the navigation of a harbour, estuary or waterway, or whose business is a qualifying trade as defined for IBA purposes. Such expenditure qualifies for a 4% WDA. A balancing allowance is given if the trade ends.

## **Tax planning key points**

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This section has explained which assets qualify for capital allowances and the consequences and opportunities of claiming capital allowances.

- Clients should inform their professional advisers of major capital expenditure in advance, so that they can receive specific advice on their particular circumstances. This will often result in tax savings.
- Particularly in the areas of plant and machinery and integral features, the tax situation is not always clear-cut. Further information can be obtained from the HMRC website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at September 2011, which are subject to change.*