Capital allowances and the super deduction

A guide for clients

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Make use of these allowances while they last.

When a business incurs costs, such as salary payments or stationary procurement, it can usually fully deduct them as expenses from its taxable profits, reducing the tax due. However, when it buys assets for operational purposes, things are not quite so straightforward.

There are HMRC incentives to help you pay less tax on the assets you buy: these are called capital allowances. But there are a myriad of rules for which this tax relief can be applied to get your head around.

Here is a rundown of the main capital allowance tax reliefs.

The super deduction

The super deduction is the most generous of the capital allowances. It gives you 130% first-year relief on qualifying plant and machinery – significantly better than even a fully deductible expense. In fact, it saves you up to £247 in corporation tax for every £1,000 you invest.

There is a catch, though: it is time-limited and expires at the end of March 2023.

It is time-limited because of its generosity. It was introduced in April 2021 as part of the Government's economic response to the COVID-19 pandemic, a sweetener to encourage apprehensive businesses to invest and boost productivity.

At the time, already low levels of business investment had dropped another 11.6% between Q3 2019 and Q3 2020 – as you will recall, this spanned some of the darkest days of the pandemic.

The Government's generosity is genuine; the positive effect on capital allowances makes now an excellent time to invest in qualifying assets.

If a business were to invest £50,000 in plant and machinery which qualified for the super deduction, it would be treated as £65,000 expenditure in its capital allowances computation (130% of £50,000). This would lead to a corporation tax saving of £12,350 as opposed to £9,500 if the deduction had been 100%.

More about the super deduction

Only a limited company can benefit from the super deduction and it can only be claimed on new plant and machinery, as opposed to second-hand assets. Moreover, your purchases must be for direct use within your business, not for leasing or renting out to customers.

There is not an exhaustive list of qualifying plant and machinery which can be referred to, but suffice it to say that HMRC considers most tangible assets that would normally qualify for the main rate pool to be acceptable for the super deduction. So, computer equipment; office furniture; vans, tractors and lorries; ladders, cranes and drills; and electric vehicle charge points, to name a few, are likely to fall into scope of the super deduction.

One notable exception is cars, even if they are solely for business use.

It is important to plan ahead if you wish to take advantage of the super deduction, particularly in relation to the timing of the purchase and when your accounting year ends. But with only a matter of months remaining until the super deduction is due to expire, you ought to start your planning process as soon as possible.

Don't forget, though, that there are other capital allowances available, even if you miss the deadline for the super deduction or your purchases don't qualify.

Annual investment allowance

The annual investment allowance (AIA) is another capital allowance tax relief which allows you to gain first year relief on plant and machinery purchases in full.

In principle, the AIA is a permanent relief. However, while it normally has a £200,000 qualifying expenditure cap, this has been temporarily boosted to £1 million. The expiry date of the temporary boost, like that of the super deduction, is 31 March 2023.

The general kinds of qualifying purchases are the same as for the super deduction but, significantly, the AIA is available for second-hand purchases and assets purchased for leasing.

The rate of relief is 100% which is generous compared to most capital allowances, but not as good as the super deduction. Therefore, if you qualified for both, it would be better to choose the super deduction over the AIA.

Remember, though, that the super deduction is only available to limited companies, so the AIA is an excellent choice for sole traders or partnerships.

It is always wise to seek the advice of an accountant to ensure your tax position is optimised.

Other capital allowances

If you are unable to claim the super deduction or AIA, you should still be able to claim what are called writing-down allowances.

The disadvantage of these is that you are unable to get the full tax benefit against the first year: something which is generally good for cashflow. Instead, you deduct a percentage of the value of the asset from your taxable profits every year.

The value is normally deemed as what you paid for the asset originally, unless it was a gift or you owned it before it had a business use. In these cases, you go with its current market value.

There are two rates which apply to writing down allowances. These are an 18% main rate and a 6% special rate. You group assets into pools based upon these rates.

Most things go into the more generous main rate pool, but a select few must go into the special rate pool. These include: items with a long life, integral parts of a building (this has a specific meaning which includes lifts, air conditioning systems and external solar shading among other things), thermal insulation of buildings and cars with high CO_2 emissions.

As you might imagine, there is a bit more to the detail of working out writing down allowances. We will not go into this here as it gets rather complex, but it is good to know that this less generous relief is there as a safety net for when the super deduction or AIA is not available.

Beat the AIA and super deduction deadlines?

With 31 March rapidly coming over the horizon, you may feel the pressure to act to benefit from the super deduction or AIA. If your accounting period straddles the deadline, the enhanced tax benefits will be applied pro rata,

based on the timing of your purchase within your accounting period as well as the deadline.

This really does make it essential to plan well with an accountant to ensure you choose the correct relief and get your budgets right.

One point to consider is, will these most generous of capital allowances end up being extended beyond March 2023? The AIA in its current guise has already seen extensions, and if they were introduced as a measure against economic headwinds, it can hardly be said that the UK is experiencing plain sailing in the economy yet.

The Institute of Directors is one voice calling for an extension, citing their own research, which shows that the super deduction has had a positive and measurable impact on business investment. Time will tell, but in these uncertain times, don’t rule anything out.

We can help you plan your capital allowances strategy

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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