Key Notes

CAVETTA CONSULTING
Unlocking Capital Allowances

Are You Making the Most of Your Allowances?

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Property investors juggle various expenses, and tax season can feel overwhelming, especially with a tax bill due. But there's good news! Capital Allowances offer a helpful tax break specifically for certain qualifying property-related costs.

By claiming Capital Allowances, investors can deduct a portion of the expenditure on assets such as fixtures, machinery, and equipment from their taxable income. This can significantly reduce the amount of tax owed, freeing up more capital for further investments or improvements.

Understanding the nuances of Capital Allowances can also aid in making strategic decisions about property acquisitions and renovations.

Moreover, it's important to stay informed about Capital Allowances as the Government tends to use them as a tool to encourage investment. Changing the rates up and down, along with adding different types of allowances to the regime, as it sees fit to encourage investment in certain areas.

For companies, where expenditure is less than £1million in the tax year there are two choices in claiming capital allowances - Annual Investment Allowances or Full Expensing. Both options provide a 100% deduction on qualifying expenditure, allowing companies to reduce their taxable profits without waiting for gradual tax relief over several years.

The simplicity of the full expensing regime (which is uncapped) may lead companies to think this is the default option going forward. However, businesses need to evaluate which method aligns best with their financial strategies and long-term planning, considering factors such as cash flow, future expenditure plans, and overall tax positions, especially on the sale of an asset.

Key Points

What is the issue?
The new Full Expensing may not offer the best tax position. Especially, if you are likey to sell the qualifying items within 7 years.

Who does it affect?
Anyone who is planning to spend money on qualifying items.

What does it mean for you?
Thought is needed about using the Full Expensing regime. If you do not plan to hold qualifying items for long period, to maximise your tax position

HOW TO CLAIM CAPITAL ALLOWANCES

As with all other allowances you need to claim via your tax return

Self Assessment Tax Return if you're a sole trader
Partnership Tax Return if you're a partnership
Company Tax Return if you're a limited company - you must include a separate capital allowances calculation

You must claim in the accounting period you bought the item if you want to claim:

- annual investment allowance or,
- 100% first year allowances eg Full Expensing

If you do not want to take your full allowances entitlement, you can claim just part of it using "writing down allowances". You can do this at any time as long as you still own the item.

However, if you used writing down allowances, you'll need to work out how much you can claim based on the pool your item is in.

This briefing is intended to provide an introductory outline to certain aspects of the UK Capital Allowances regime. It should not be used instead of obtaining proper professional advice. The outline is for guidance only and is not an appropriate basis for decision-making.

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THE FUNDAMENTALS OF THE RELIEF

So, let's break down the two main options: Annual Investment Allowance (AIA) and full expensing.

Annual Investment Allowance (AIA):

- AIA allows anyone to deduct the full cost of qualifying assets from your taxable profits in the same year you incur the expense
- This applies to most plant and machinery (excluding cars) up to a certain limit. As of April 2023, this limit is a generous £1 million
- This is a simple and straightforward way to reduce your tax bill in the short term.

Full Expensing (FE):

- Introduced in April 2023, full expensing allows you to claim 100% tax relief on qualifying capital expenditure.
- The level of claimable expenditure is uncapped
- It is only for companies, paying UK corporation tax
- FE provides a 100% first-year capital allowance for qualifying main pool expenditure and 50% first-year allowance for special rate pool expenditure (e.g. integral features).

The unlimited FE regime might seem like the obvious choice for companies moving forward, but could they be missing something?

Let's not forget about an old companion: the Annual Investment Allowance (AIA). First introduced in 2008, the AIA enables anyone in business to claim 100% relief on most plant and machinery, up to the AIA limit. In 2019, the limit was increased from £200,000 to £1 million per company group, encompassing a substantial part of the typical annual spending for small to medium-sized companies.

When the 'super-deduction' was introduced in 2021, the AIA took a back seat. This deduction offered up to 130% relief on qualifying assets purchased between April 1, 2021, and March 31, 2023, to discourage companies from delaying capital expenditure until after April 1, 2023, when the main corporation tax rate would jump from 19% to 25%. An example of the Government using the regime to influence decion making.

As the super-deduction shifted to full expensing on April 1, 2023, companies may assume they should follow suit. Although, this may not be the best option for some.

EXAMPLE

Example: Expensive Engineering Ltd has an existing capital allowances main pool balance of £75,000 and acquires a new lathe for £15,000. The lathe is sold the following year for £10,000.

If Full Expensing (FE) regime is utilised, the company gets relief for the £15,000 in period 1, but when sold, face a balancing charge in period 2 of £10,000, i.e. £5,000 of relief has been obtained.

However, if the Annual Investment Allowance (AIA) regime is used the company still gets the £15,000 relief in period 1, but in period 2 there is no balancing charge.

Instead, the £10,000 is deducted from the capital allowances main pool. This reduces the amount of writing down allowances the company gets, but only by £1,800. So in this example, by utilising the AIA, instead of the FE regime saves £8,200.

In reality this is only a timing difference, as the FE leaves the capital allowances pool at the higher level of £75,000. However, with writing down allowances applying at 18%, it will take several years for the full tax saving to received.

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So, even though relief under Full Expensing (FE) is unlimited, it is generally advisable to prioritise claiming the AIA for two main reasons:

- The AIA offers 100% relief in the year of spending on Special Rate Pool assets, while FE provides only 50% relief initially, with the remaining amount transferred to the Special Rate Pool. This is then subject to Writing Down Allowances, currently at a rate of only 6% per year.
- Assets that have full expensing claimed on them will incur an immediate balancing charge upon disposal, which is a taxable receipt based on the proceeds received. Assets acquired using the AIA are not subject to balancing charges.

CONCLUSION

Numerous companies have utilized the super-deduction in recent years but might have neglected the current AIA regulations after the implementation of full expensing, potentially underestimating the consequences when it comes to asset sales. From our perspective, the AIA presents a preferable choice, especially in cases involving substantial carried forward capital allowance pools.

So you can see where the expenditure is around the £1 million mark, thought should be given to how capital allowances are claimed. Consulting with a tax advisor could add value to your property portfolio. They can help you navigate the specifics of your situation, ensure you're claiming the most appropriate allowances, and maximize your tax benefits. With the right knowledge and strategy, you can transform tax season from a headache to a chance to boost your property investment journey!

About us

At Ċavetta Consulting our directors have considerable experience advising businesses, property investors, landlords and occupiers on all capital allowances implications that impact their business.

Our fee structure is tailored to take account of the tax status of the individual or business and is designed to add value to your business.

We offer free advice to small businesses at the pre-planning stage of their business to make them aware of the benefits the tax system allows and a no obligation review of completed or potential schemes in order to determine whether a viable claim for property.

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