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Making the right claims

Adjacent Digital Politics provides a brief overview for the rules regarding capital allowances on plant and machinery…

Understanding tax allowances can be a tricky business, but it doesn't have to be if you are armed with the latest information. HM Revenue & Customs (HMRC) itself states that it "wants to make it easy for customers to deal with their taxes and get things right, by making our products and processes more simple and straightforward, and by improving our customer service." Along with the right information, timing is critical to any business in ensuring that tax allowances are utilised before it is too late.

Tax allowances are claimed by businesses – also known as capital allowances on purchases or investments made on business assets. You cannot directly deduct your expenditure on those assets when calculating your profits or losses, instead you can deduct a capital allowance. This applies whether you're self-employed and pay Income Tax or are a company or organisation that's liable for Corporation Tax.

Many common business assets such as office equipment, furniture and machines or tools, may be considered to be plant and machinery for capital allowance purposes, and expenditure on them might qualify for plant and machinery allowances.

Here, we provide a brief overview of which types of assets might count as plant and machinery for capital allowance purposes. Particular attention should be paid to the changes to the Annual Investment Allowance (AIA), which has been amended, subject to legislation.

Items that qualify for plant and machinery allowances

Tools, machinery, vehicles and other equipment you own (having bought them for your business) will generally qualify for plant and machinery allowances.

Some common examples include:

- Vans;
- Cars;
- Tools;
- Furniture;
- Computers;
- Machinery;
- Equipment.

However, different assets may be eligible for different plant and machinery allowances. For more information, view the types of plant and machinery allowances section.

There are also certain fixtures in buildings, and integral features in buildings, that qualify for plant and machinery allowances.

Capital allowances relating to buildings and renovation
http://www.hmrc.gov.uk/capital-allowances/buildings.htm
Find out more about what qualifies as plant and machinery
http://www.hmrc.gov.uk/manuals/camanual/CA21000.htm

Qualifying rules for plant and machinery allowances

To qualify for plant and machinery allowances, all the following must apply:

- You must have incurred capital expenditure on the provision of plant and machinery that is used wholly or partly for the purposes of your business. You must own the asset in question as a result of incurring that expenditure;
- The asset must not be something you buy and sell by way of your trade, although you might eventually sell it for some other reason - you may then have to make an adjustment to your capital allowances. The asset must also not get used up in producing what you sell or supply by way of your trade;
- The asset must generally be expected to last for more than two years.

In most cases, you cannot claim capital allowances for assets you lease from someone else. You may be able to claim certain capital allowances for assets that you own and lease out to other users as part of your business, but only in very particular circumstances.

If you partly use an asset for non-business use, for example, for private use - you can still claim capital allowances on the business use of the asset. The allowances you claim must be reduced by the amount arising out of your non-business use so that only the business use proportion is taken into account.

Plant and machinery allowances: long funding lease
http://www.hmrc.gov.uk/manuals/camanual/CA23810.htm
Plant and machinery allowances on fixtures
http://www.hmrc.gov.uk/manuals/camanual/CA26050.htm

Types of plant and machinery allowances

There are a number of allowances available for expenditure on plant and machinery. The term 'accounting period' is used here, but you will see the term 'chargeable period' used in the HMRC Capital Allowances Manual.

First-year allowances – some of which are also known as 'enhanced capital allowances' or ECAs

Currently, there are 100% first-year allowances available for expenditure on certain specific types of asset. This means you can claim the full expenditure on these assets as a deduction when calculating your taxable profit or loss for the accounting period when you spent the money, if all the conditions are met. The key types of assets that qualify for first-year allowances are:

- New, unused cars with CO_2 emissions of not more than 110 grams per kilometre driven;
- Certain designated energy-efficient equipment;
- Certain environmentally beneficial, currently water efficient, equipment;
- Equipment for refueling vehicles with natural gas, biogas or hydrogen fue;
- New zero-emission goods vehicles, such as electric vans.

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Writing-down allowances (WDA)

WDA are annual allowances that reduce, or 'write down' any balance of capital expenditure on plant and machinery that you haven't been able to claim either the annual investment allowance or a first-year allowance for, and on residual balances of expenditure that you have carried forward from the previous accounting period.

There are two rates of WDA for plant and machinery. To calculate them, you first group your expenditure into different pools:

- The main pool - this includes expenditure on most items - the rate is 18%;

- The special rate pool - this includes special rate expenditure including long-life assets, integral features, certain thermal insulation and some cars - the rate is 8%.

WDA for expenditure on short-life assets, or assets that you have used partly for non-business purposes, are calculated individually. That expenditure is therefore added into a separate pool for each asset, known as a single asset pool. A business may have several single asset pools. The rate of writing-down allowance to apply to each pool will depend on the type of asset on which the expenditure was incurred. The link below gives more information about writing-down allowances.

http://www.hmrc.gov.uk/capital-allowances/plant.htm#5

Small Pools Allowance (SPA)

If in either the main or special rate pool the remaining balance is £1,000 or less after you have carried out the steps below, then instead of claiming a percentage WDA you can claim an allowance, sometimes called the SPA, for the whole amount remaining in that pool.

Steps to work out if you can claim the SPA for a given pool:

- Start with the unrelieved capital expenditure carried forward from the previous accounting period;

- Add any new capital expenditure on which you have not claimed a first-year allowance in that period;

- Deduct the amount of AIA you wish to claim for the capital expenditure incurred in that period;

- Add the balance of any expenditure in a previous period on which a first-year allowance was claimed and which you have not already brought into the pool;

- Deduct any proceeds for items that you have sold or disposed of from that pool in that period;

- If the residual balance is £1,000 or less you can claim the SPA on the whole balance.

The main or special rate pool will continue to exist, but the balance carried forward to the next year will be nil. The links below give more information about SPA.

Small Pools Allowance – for residual balances of £1,000 or less
http://www.hmrc.gov.uk/capital-allowances/plant.htm#17

Plant and machinery allowance: first-year allowance
http://www.hmrc.gov.uk/manuals/camanual/CA23100.htm

Annual investment allowance (AIA)

Most businesses can claim an AIA for expenditure on most plant and machinery, apart from cars. In many cases (depending on your level of expenditure) this may mean that you can claim your entire expenditure on qualifying items against this allowance. In the 2014 March Budget, the Chancellor, George Osborne has improved on the AIA by doubling it. Going forward, it has been extended to 2015 and will now be worth £500,000.

The cost to implement the policy is likely to be around the £2bn mark and reflects the government's desire to back businesses which are looking to invest. According to the chancellor, some 99.8 per cent of businesses will pay no tax on investment.

There is more information available on the HMRC website concerning the new AIA.

http://www.hmrc.gov.uk/capital-allowances/plant.htm#3

AIA is available for most businesses, including partnerships. It is not available for trustees or mixed partnerships (partnerships which are not made up entirely of individuals).

Businesses can claim an AIA for capital expenditure incurred on most items of plant and machinery.

The AIA was introduced for expenditure incurred on or after 1st April 2008 for Corporation Tax or 6th April 2008 for Income Tax.

What you can and cannot claim for

Any new expenditure on plant and machinery assets bought after 1st April 2008 for Corporation Tax, or 6th April 2008 for Income Tax qualifies for AIA, apart from these exceptions:

- Cars - see the section below on capital allowances on cars;
- Plant and machinery previously used for another purpose, for example, a computer used at home and introduced into your business;
- Plant and machinery gifted to your businesss;
- Expenditure incurred in the accounting period in which your business ceases.

Qualifying expenditure: Annual investment allowance

http://www.hmrc.gov.uk/manuals/camanual/CA23084.htm

Full and in-depth information regarding the rules and advice is available on the HMRC website. To view, please click here:

http://www.hmrc.gov.uk/capital-allowances/plant.htm

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Annual Investment Allowance doubles to £500,000 in tax relief

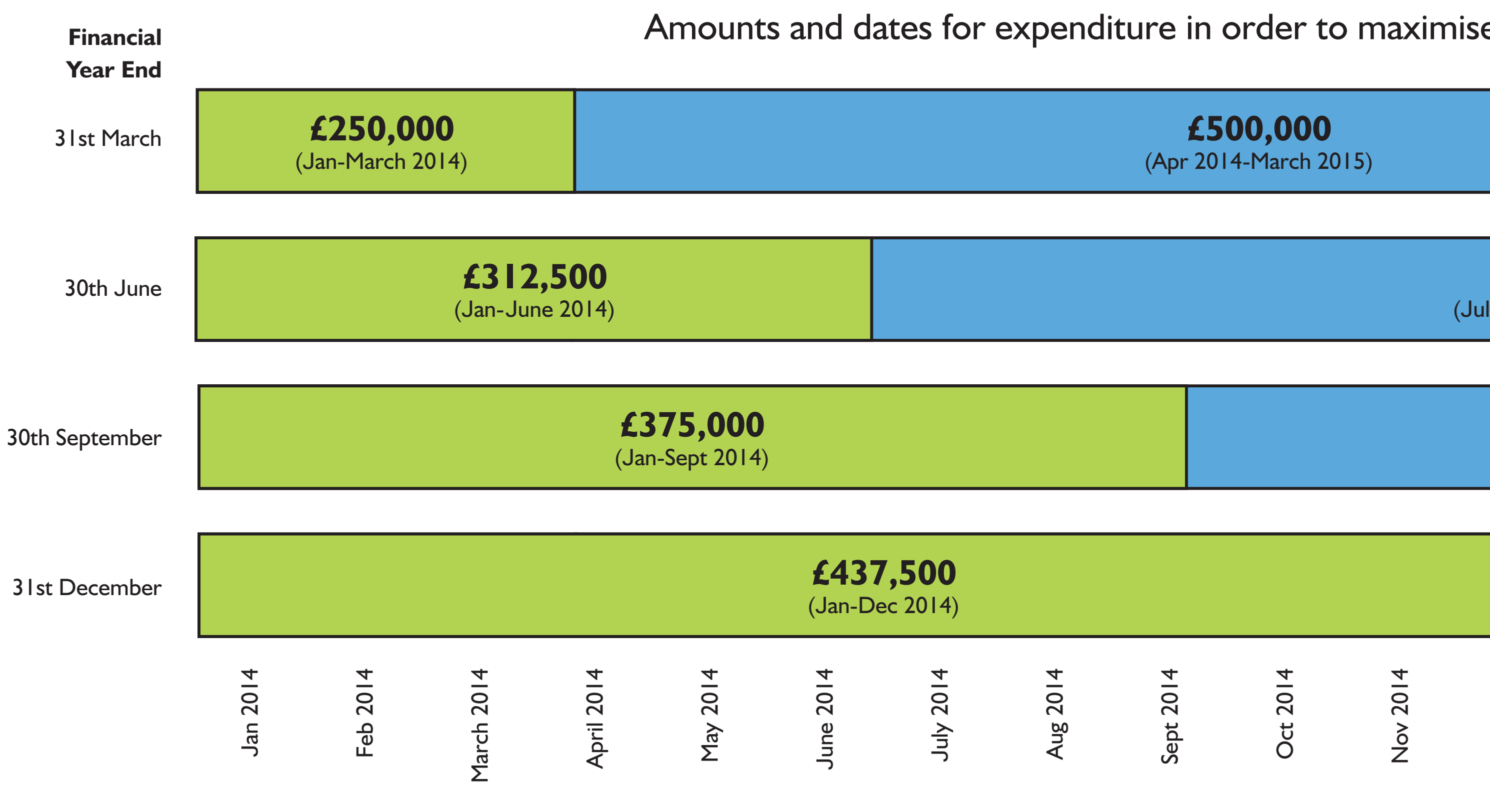
JCB Finance explains some unexpected changes in the Budget that represent a £500,000 tax saving opportunity for UK businesses contemplating purchasing plant and machinery.

In a surprise move the chancellor announced in his March 2014 Budget a temporary increase in the Annual Investment Allowance (AIA) from £250,000 to £500,000 with it reverting back to £25,000 on 1st January 2016.

The enhanced AIA of £500,000 is available for capital expenditure on plant, machinery and commercial vehicles (not cars) purchased from April 2014 until 31st December 2015. This an important tax incentive which accelerates the tax relief so that 100% of eligible expenditure can be offset against taxable profits in the first year instead of taking up to 12 years to reclaim 90% of the original cost using the normal 18% annual writing down allowance. In effect for every £1 spent the Government will give you £1 back in the form of relief against your taxable profits. The net benefit will depend on the rate of income tax or corporation tax that your business pays – which could be between 20% and 45%. It is the equivalent of a subsidy to encourage businesses to invest in plant and machinery.

Capital expenditure via a Hire Purchase (HP) agreement is also eligible for exactly the same AIA, just as if you had paid cash, but you will also gain a terrific cash flow advantage. Potentially your business could gain up to £500,000 in tax relief after only having paid the deposit and the interest charged is also 100% tax deductible. If you have not already planned how to maximise the benefit speak to your accountant now.

£500,000 Annual Inv



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Timing is critical

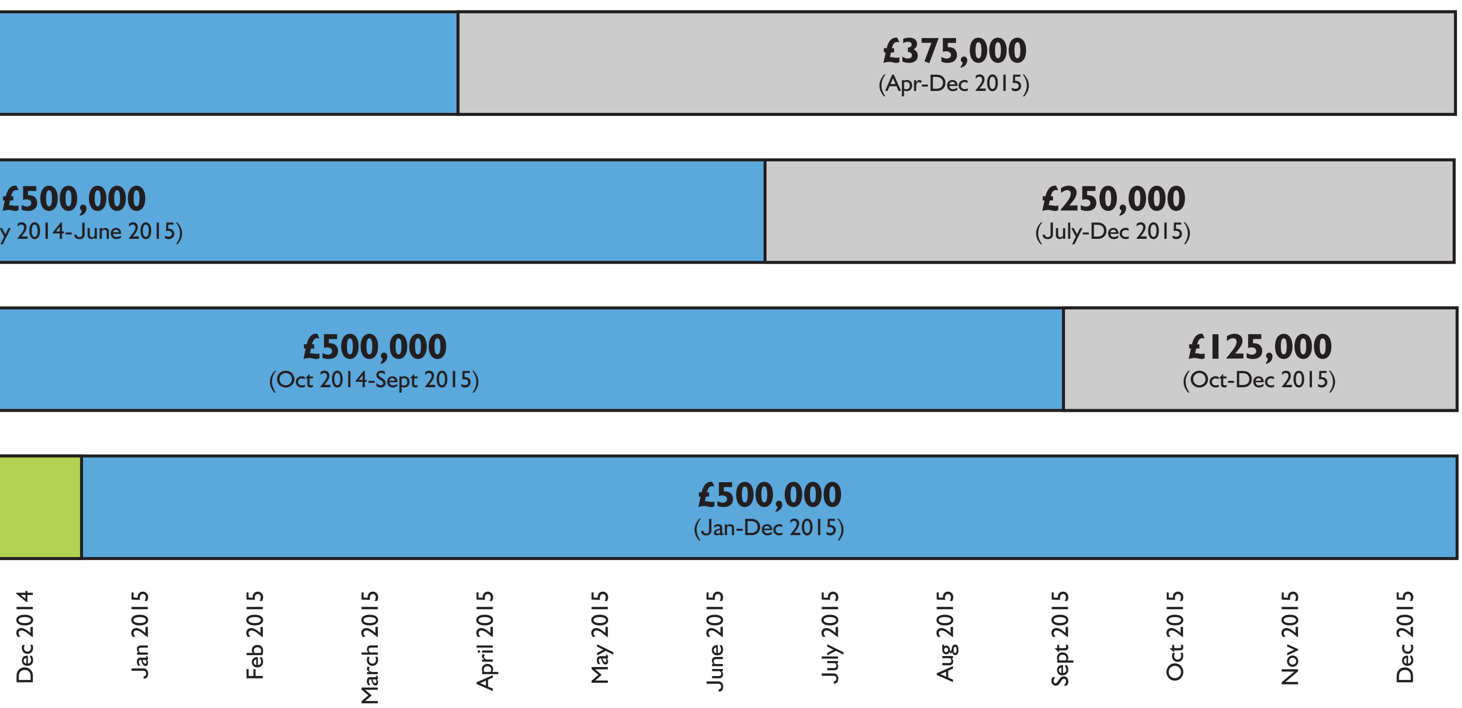
Proper advice is needed because different financial years that straddle either the tax year or calendar year end may result in complicated calculations that could result in a lesser AIA being granted in that financial year. The chart below illustrates this by showing four different financial year end companies and how vital it is to spend the right amount within the right periods in order to maximise the tax benefits. Given the lead times of some plant and machinery, from order to delivery, this also needs to be carefully factored in to your buying plans. Get the timing and /or the amounts wrong and your business could either miss out on available tax relief or worst still, end up paying far more tax then is required.

Confusion!

Unfortunately it seems that some financial advisors have been slow in coming to terms with the AIA, particularly because this represents the 5th change since its introduction in 2008! Combined with changes to corporation tax and income tax, during the same period, many have struggled to keep abreast with how much this important tax incentive could save their business. The 4th set of AIA changes, introduced in January 2013, made life particularly complicated because the changes happened mid-way through a tax year. In addition there seems to be some confusion in the Plant Hire sector with many Plant Hire businesses being advised that they are not eligible for the AIA. The seeds of this confusion may have been sown in April

vestment Allowance

e the potential tax benefit according to a business' financial year end



2008 when First Year Allowances (FYA) were replaced by the AIA. Before 2008 many accountants had been caught out by HMRC disallowing FYA claims made on behalf of Plant Hirers because the business was supplying non-operated plant (plant supplied with an operator could claim the full FYA). This ruling was not carried over to the AIA so all businesses, including Plant Hire businesses, can claim the AIA – the only exceptions are Mixed Partnerships or Trusts (i.e. those in which a company is a member).

What savings can be made?

Imagine the following scenario: in 2015 a Limited Company is rapidly approaching the end of its tax year and the accountant fears that a big tax bill is looming. Even after claiming all available business expenses, a profit of £500,000 remains, which would attract the 21% corporation tax rate and a tax bill of £105,000. The company's financial year ends on the 31st March.

The accountant explains that, if the business uses hire purchase to invest £500,000 in replacement plant which is delivered and available for use within the business by 31st March 2015, then the full £500,000 AIA will apply. Paying a 10% deposit (£50,000) and borrowing £450,000 over three years on hire purchase equates to a £200,000 outlay in the first 12 months, followed by £150,000 in each of the subsequent years (net of interest charges).

Over half of the £200,000 expenditure in the first year has effectively been paid by HM Revenue & Customs. Not only that, but the company has managed its cash flow in an exemplary fashion – claiming the maximum £500,000 AIA but with an outlay of only £50,000 (the deposit) in the same tax year. Typically most hire purchase agreements are paid monthly in arrears so the first monthly payment would fall due at the end of April which is in the new tax year. The actual interest element charged is 100% tax deductible. Paying £500,000 in cash on day one would only net the same AIA tax benefit.

However, be warned because the above scenario is relatively simple to interpret. It cannot be stressed enough the importance of using the chart to give an indication of the proportion and timing of expenditure in order to maximise the tax benefits. Working closely with your accountant or FD will help plot a course of action that suits your business' circumstances. Other factors being equal, if your business is contemplating purchasing plant in the near future, there are some strong tax-based and cash flow arguments to carefully plan plant purchases before the end of your financial year and certainly before 1st January 2016, so that you can maximise on the available £500,000 tax relief.

If the business is likely to spend more than £500,000 per annum or the amount shown in the chart for its financial year then, once this amount has been spent, leasing plant and machinery may prove to be the next best tax efficient funding method with lease instalments that are 100% allowable against taxable profits.

Leasing alternative can maximise tax relief

One result of the temporary introduction of successive increases in the AIA is that it has prompted many companies to review their purchasing plans with a healthy dose of tax planning thrown in for good measure. Whilst hire purchase remains the most popular form of funding, a number of companies have realised that they have a core group of machines or vehicles that they plan to operate for a set period which are unlikely to be changed or disposed of before that period has expired. Once the threshold of the current £500,000 AIA has been breached these same companies are asking whether there is a quicker way to write off these assets against taxable profits. The answer is yes because, with an Operating Lease, 100% of the monthly instalments can be offset against taxable profits. Run the machine for three years and 100% could be written off. Depending on the make and model of machine and its respective residual value, an Operating Lease could offer 90% better tax write-off in as little as three years compared to paying cash or using Hire Purchase.

Ironically, the higher the depreciation the greater the tax write-off and the higher the rate of corporation tax or income tax the higher the actual amount saved. However, there is another reason to consider an Operating Lease, which for many companies may be just as important as the speed of tax write-off. Increasingly a number of companies are turning to Operating Leases to reduce the level of debt carried on their balance sheet. With an Operating Lease or Contract Hire agreement the plant will not appear as an asset on the business' balance sheet (the asset is owned by the leasing company). This in turn can dramatically improve such key accounting ratios as Return on Capital Employed because the same turnover and profit is effectively measured against a smaller asset base.

Ultimately your accountant or finance director will need to run the calculations to see what is best for your business coupled to a sound reason for investing in additional plant and machinery in the first place.

The AIA is scheduled to revert back to £25,000 from 1st January 2016. If that happens the tax efficiency of an Operating Lease compared to paying cash or using Hire Purchase will be brought in to even sharper contrast. Talk to JCB Finance about the leasing alternatives including JCB FlexiLease – a new type of Operating Lease that pays back to the lessee any profits on sale of the leased asset.

JCB Finance Ltd is authorised and regulated by the Financial Conduct Authority. JCB Finance provides asset finance for UK businesses for both JCB and non-competitive plant, including vehicles and cars but it is not a tax or financial advisor – always seek advice from your accountant or finance director, because every business' circumstances are different. Businesses should not make investment decisions purely on a tax basis – there should be a compelling business case for the investment in the first place.

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