

Inland Revenue

Capital Allowances and Depreciation Overview

Depreciation is a calculation in a set of accounts to recognise the falling value of fixed assets as agreed by the owners/directors.

A debit entry (charge) is made in the profit and loss account for the period's depreciation, and a credit entry (reserve) goes to the balance sheet depreciation.

The annual rate, or charge, is generally designed to reflect the falling market value of the asset. It is normally calculated on a time only (e.g. yearly) basis, but in some cases on a usage or activity basis to reflect the impact of wear and tear.

There are three main methods of calculation: -

1. Straight line: the asset cost value divided by a number of years giving a regular charge for each year.
2. Reducing balance: a percentage taken off each year from the reduced balance brought forward.
3. The valuation: each asset reviewed by a specialist to establish a new market value at each year-end.

Capital Allowances are the statutory charge amounts allowed for an assets' devaluation in the Tax Computation to assess the tax charge on the business profits.

In the tax computation calculation the depreciation charge is added back to the profit and loss for the period and the capital allowance figure is used in its place to assess the net profit before tax.

The government each year in the annual budget confirms the statutory capital allowances.

Capital allowances are charged for each accounting period, and if this is longer than 18 months, the charges must be split into shorter periods and charged separately.

A claim for capital allowances can be made up to 12months after the filing date for the tax return.

Capital Allowances can only be claimed on the NET value of the asset where a business is VAT registered.

The full capital allowances do not need to be claimed in any year and can be carried forward. Therefore if there are no profits to claim an allowance against, it can be carried forward into later years.

A partnership must claim its capital allowances as a business, and not as individual partners.

- Initial first year Allowance

From 1st April 2009 (individuals 6th April) companies purchasing capital items up to £50,000 will have a 100% first year allowance (annual investment allowance or AIA), excluding cars. From 2010 this increased to £100,000 and from April 2012 this will reduce to £25,000. Thereafter the balance is written down at 20% on the reducing balance method.

Energy saving plant has 100% if bought after 1st April 2001.

- Industrial and Commercial Buildings

Enterprise Zones normally have a 100% initial allowance in the first year. A conversion of industrial to dwelling attracts a 25% first year allowance. Other areas have a written down allowance of 4% per annum.

- Cars

For cars costing over £12,000, there is a maximum written down allowance of £3,000, but only the business proportion is allowed, so if there is 25% private usage only £2250 can be claimed.

Cars with an emission rate of ≤ 120 gm/ml have a first year allowance of 100% as do Hybrid cars, as long as the car is new at purchase and the money is spent between 17th April 2003 and 31st March 2008.

- R&D

Capital expenditure on R&D can attract capital allowances of 100% (Small and Medium sized companies – larger companies have a different %) as long as it: -

- Involves innovation and creativity in science and technology.
- The research is related to the business.
- The business is classed as a trader and not a profession or vocation.

- Plant & Machinery, Commercial Vehicles and cars under £12,000.

A pool can be created for plant, machinery, commercial vehicles and cars costing less than £12,000. Where there is an element of private use, the item(s) involved need to be calculated individually and the percentage applied accordingly.

- Short Life Assets (SLA).

Special rules apply for short life assets where the assets will become obsolete or wear out, and if this is less than 5 years a separate pool is required. An election is required to treat the asset as a SLA

- Long Life Assets (LLA).

If an asset is expected to last for more than 25 years the asset should be separately pooled and a rate of 6% applied. An asset is not a LLA if it is an office, shop etc.

- Leased Assets.

Capital Allowances are applicable on items that are leased out to other companies, but the first year allowance is not available.

Knowing when Capital Allowances have gone beyond the basics is important.

HelpAccountants would recommend that when capital allowances go beyond the standard reliefs that advice is sort.

Roche Associates can advise on Capital Allowances and Land Remediation Tax Relief.

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The budget paper raling to the changes announced in June 2010 can be found at

<http://www.hmrc.gov.uk/budget2010/bn04.pdf>