

Capital allowances changes

(Lecture B1127/ B1128 – 17.01/ 11.41 minutes)

Various amendments have been made to the capital allowances regime in the Budget on 29 October 2018 (Now Finance Act 2019). The main ones involve:

- the introduction of a structures and buildings allowance (SBA) for new non-residential buildings;
- reducing the WDA from 8% to 6% for assets falling into the special rate pool;
- a temporary increase in the maximum amount of 100% AIAs from £200,000 to £1,000,000;
- the abolition of the 100% enhanced capital allowances (ECAs) rules for expenditure on certain energy-saving and water efficient plant or machinery; and
- a four-year extension to the special 100% FYAs for expenditure on electric charge-points.

After the relatively minor capital allowances changes in recent years, the reforms announced by the Chancellor on 29 October 2018 (Now Finance Act 2019) are wide-ranging and represent the most significant amendments to the capital allowances code since 2008.

The Government have been swift to act on the Office of Tax Simplification's recommendations following the consultation on capital allowances earlier this year and the Government's aim of improving the UK's international competitiveness and encouraging investment will be warmly welcomed by UK businesses and investors at a time of increasing uncertainty.

SBA – key features

The main features of this investment incentive, which is significantly broader than the old industrial buildings allowances legislation, are as follows:

- relief will be given at a flat rate of 2% over a 50-year period;
- relief will be available for all new commercial structures and buildings (including the costs of new conversions and renovations);
- all relevant structures and buildings, whether situated in the UK or overseas, will qualify, provided that the business which incurred the expenditure is within the charge to UK tax;
- relief will be limited to the costs of physically constructing the structure or building (including the costs of any demolition or land alterations necessary for such construction), together with any direct costs which are required in order to bring the asset into existence;

- relief will be available for eligible expenditure incurred where the contracts for the construction works are entered into on or after 29 October 2018;
- claims can only be made from when a structure or building first comes into use;
- land costs will not be eligible for relief nor will the costs of obtaining planning permission;
- the claimant must have an interest in the land on which the structure or building is put up;
- dwelling houses will not qualify nor will any part of a building used as a dwelling where the rest of the property is commercial;
- the sale of a property qualifying for the SBA will not give rise to a balancing allowance or balancing charge – instead, a second-hand purchaser will simply take over the residual 2% allowances for the remaining 50-year period;
- expenditure on integral features will continue to be allowable as before, ie. such items will qualify for AIAs and special rate pool WDAs; and
- SBA expenditure will not be eligible for AIAs.

For SBA purposes, structures and buildings include offices, retail and wholesale premises, factories, warehouses, walls, bridges and tunnels. Capital expenditure on the renovation or conversion of existing commercial structures and buildings will, as mentioned above, also qualify. HMRC add:

‘The costs of construction will include only the net direct costs related to physically constructing the asset, after (taking into account) any discounts, refunds or other adjustments. Capital expenditure does not include costs that can be allowed as a deduction in calculating the profits of the business.’

WDAs for assets falling into special rate pool

Certain capital expenditure nowadays only qualifies for WDAs at a special rate of 8%, calculated on a reducing balance basis. This is known as ‘special rate expenditure’. The main items that fall into this special rate pool are expenditure on:

- (i) thermal insulation;
- (ii) integral features of buildings and structures;
- (iii) long-life assets;
- (iv) cars with CO₂ emissions > 110g/km (130g/km if incurred pre 1 April 2018); and
- (v) expenditure on solar panels.

Although the main WDA rate stays at 18%, the Chancellor has decided that, as a quid pro quo for the introduction of the SBA, the special rate pool WDAs should be reduced from 8% to 6%. This will take effect from 1 April 2019 (for corporation tax) and 6 April 2019 (for income tax).

For chargeable periods spanning the relevant starting date, the WDA rate will be an average of the rates before and after the change. So, for a company with calendar year accounting periods, the special rate pool WDA for the year ended 31 December 2019 will be:

$$(3/12 \times 8\%) + (9/12 \times 6\%) = 6.5\%$$

One's initial feeling is that, for many clients, the benefit of the new SBA will be significantly outweighed by the drop in this form of WDA. However, small businesses will still be able to cover most of their special rate expenditure by a claim for 100% AIAs in the period in which that expenditure is incurred.

New AIA limit

Since 1 April 2008 (for companies) or 6 April 2008 (for sole traders and partnerships), most businesses, regardless of size, have been able to claim 100% AIAs on their expenditure on plant or machinery – other than on cars – up to a specified annual amount each year.

With effect from 1 January 2016, the maximum AIA entitlement was set at what was meant to be a permanent limit of £200,000 by F(No2)A 2015.

Despite this, on 29 October 2018, the Chancellor announced that the AIA limit was to be increased fivefold to £1,000,000 on 1 January 2019 for a temporary period of two years. On 1 January 2021, the cap will go back to £200,000. This temporary measure is designed, in the words of HM Treasury, 'to stimulate growth in the economy by providing an additional time-limited incentive for businesses (particularly medium-sized businesses) to increase, or bring forward, their capital expenditure on plant or machinery'.

Where a business has a chargeable period that spans the operative date of the increase, the maximum allowance for that period comprises two parts:

1. the AIA entitlement, based on the £200,000 limit, for the portion of the period falling before 1 January 2019; and
2. the AIA entitlement, based on the temporary cap of £1,000,000, for the portion of the period falling on or after 1 January 2019.

In other words, it will be a time-based calculation. However, it is important to note that the AIA for any capital expenditure incurred in the period before 1 January 2019 is restricted to a maximum of £200,000 (where the actual expenditure was greater), given that this was the upper limit claimable prior to the temporary increase.

Abolition of 100% ECAs

From 31 March 2020 (companies) and 5 April 2020 (unincorporated businesses) the scheme, that currently provides a 100% first year deduction for expenditure on qualifying energy-efficient and water saving plant or machinery, is to be abolished. The removal of this relief is particularly disappointing given that first year tax credits for loss-making companies were extended by S29 FA 2018 for a further five years through until 31 March 2023.

Having said that, the products on the Energy Technology List and the Water Technology List will be updated next year for one last time to reflect developments in eligible plant or machinery. It is understood that the revenue saved by this change of policy will be used to fund the Industrial Energy Transformation Fund.

100% FYAs for expenditure on electric vehicle charge-points

The 100% FYA regime in S45EA CAA 2001 for expenditure incurred on new charge-point equipment for electric vehicles is being extended for four more years to 31 March 2023 (for corporation tax) and 5 April 2023 (for income tax).

This measure is, in the words of HM Treasury, ‘designed to encourage the use of electric vehicles by supporting the development and installation of electric charging equipment (for) such vehicles’. It is intended to promote the use of cleaner vehicles by making electric charge-points a more common feature and complements the 100% FYAs for expenditure on:

- cars with low CO₂ emissions (S45D CAA 2001); and
- zero-emission goods vehicles (S45DA CAA 2001).

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