

Capital allowances (Lecture B1252 and B1253 – 19.08 / 14.33 minutes)

Super-deductions and other first-year allowances

Clause 9 provides for

1. Expenditure qualifying for a 130% super-deduction (Clause 9(2))
2. Expenditure qualifying for a first-year allowance of 50% (Clause 9(3)), and
3. Expenditure qualifying for a first-year allowance of 100% (Clause 9(4))

Conditions common to all three items

This only applies to expenditure incurred by a company within the charge to corporation tax between 1 April 2021 and 31 March 2023. It includes qualifying assets acquired under a hire-purchase contract.

However, if a contract for the expenditure was in place before 3 March 2021, the expenditure date is treated as being the order date so that it will not qualify for these allowances.

The assets acquired must be on plant and machinery which is unused and not second hand.

The assets must not be within the general exclusions of s46(2) CAA 2001

- Expenditure incurred in the period when the trade is discontinued,
- Cars
- Long-life assets
- Lessors
- Where the expenditure is connected with a change in the nature or conduct of the trade or business by someone other than the purchaser of the asset and obtaining a first-year allowance is one of the main benefits from making the change
- Plant and machinery bought initially for a non-qualifying activity (or used for a long funding lease), then later used in a qualifying activity
- Plant and machinery used previously for one property letting business (including furnished holiday lettings) and then used for another property letting business where the market value is used to determine the expenditure for the new property letting business

Super-deductions

Expenditure qualifies for a super-deduction of 130% of the cost if, in addition to the above conditions

1. It is not special-rate expenditure (which is addressed by Clause 9(3))
2. It is not special-rate expenditure for use wholly or partly for a ring fence trade

To understand some of the adjustments that are needed on the purchase or disposal of a super-deduction asset, the idea of it seems to be to give (nearly) a 25% tax saving on the expenditure before the main rate of corporation tax changes to this from 1 April 2023 (130% deduction

multiplied by the tax rate up to 31 March 2023 of 19% is 24.7%), to encourage companies not to delay capital investment until the main rate changes.

If the expenditure is incurred before 1 April 2023 but in an accounting period that straddles that date, an adjustment is made to the qualifying cost to ensure that the 130% relief and 25% rate of corporation tax are not both available at the same time.

The rate of super-deduction will be pro-rata to the number of days of the accounting period that fall before 1 April 2023, with the final amount being 100% plus $(30\% \times \text{days of the period before 1 April 2023} \div \text{total days in the accounting period})$ (Clause 11).

Example

A company incurs qualifying super-deduction expenditure on 25 February 2023 of £698,540. It has a year ended 31 December 2023.

The rate of super-deduction is $100\% + (30\% \times 90 \div 365) = 107.40\%$ (rounded to 2 decimal places).

The company will be able to claim a super-deduction on $(£698,540 \times 107.40\%)$, i.e. £750,213 (based on the unrounded percentage).

This will save corporation tax at 19% of £142,540, an effective tax saving of $(142,540 \div 698,540)$ 20.4% overall.

Additional VAT liabilities

If there is an additional VAT liability treated as capital expenditure after the plant and machinery has been purchased (for example, under the capital goods scheme for computer equipment costing more than £50,000), a similar calculation will be made to the example above where the extra liability arises before 1 April 2023.

If it arises on or after 1 April 2023, the extra VAT liability will qualify for 100% capital allowance only. This is because s236(2) CAA 2001 treats an additional VAT liability caused by an adjustment to capital items as incurred on the same plant and machinery and qualifying for the same first-year allowance.

However, the date of expenditure is the end of the period when the VAT adjustment is made, which is usually 30 September, 31 October or 30 November for capital goods scheme purposes depending on when the company's usual VAT return periods run to.

If, by this time, the rate of corporation tax is 25%, then the company will get a 100% deduction for the extra VAT so it will save 25% tax on the extra VAT cost.

If it was incurred before 1 April 2023, the company would have qualified for 130% deduction, but saving tax at 19%, which, as discussed above, is an effective saving of 24.7%.

Example

A company with a 31 December year end spends £1,506,000 plus (20%) £301,200 VAT, on a new computer system on 30 October 2021, having contracted for it on 15 March 2021. It prepares quarterly VAT returns to 31 January, 30 April, 31 July and 31 October each year.

The company's partial exemption recovery rate has been:

| | |
|-----------------------------|-----|
| Quarter to 31 October 2021: | 73% |
| 12 months to 30 April 2022: | 68% |
| 12 months to 30 April 2023: | 60% |

Calculate the capital allowances on the asset for the years ended 31 December 2021 to 31 December 2023.

Analysis

Year ended 31 December 2021

The company would claim a 130% super-deduction on the cost, including irrecoverable VAT.

The cost is £1,506,000 plus 27% irrecoverable VAT at 20%, i.e. £1,587,324.

The super-deduction will be 130% x £1,587,324, i.e. £2,063,521 and this will save corporation tax at 19%.

Year ended 31 December 2022

There was a partial exemption adjustment to the VAT recovery on 30 April 2022, calculated as:

$$£301,200 \times (68\% - 73\%) \text{ i.e. an extra VAT liability of } £15,060.$$

This increase of £15,060 is capital expenditure on the original computer system and is eligible for a super-deduction of 130% as it falls in an accounting period ending before 1 April 2023.

Year ended 31 December 2023

There was a capital goods scheme adjustment to the VAT recovery for the year to 30 April 2023 and this would have been made in the VAT quarter to 31 October 2023. The adjustment is calculated as follows:

$$£301,200 \times (60\% - 68\%) \div 5 \text{ (years), i.e. an extra VAT liability of } £4,819.$$

This extra expenditure is treated as incurred on 31 October 2023. As this falls on or after 1 April 2023, it is entitled to a 100% deduction only (Clause 11(3) – 11(5)).

Disposals of super-deduction assets (Clause 12)

A balancing charge will always arise on the disposal of a super-deduction asset.

If the disposal takes place in an accounting period ending before 1 April 2023 (which is perhaps unlikely in practice), the **relevant proportion of the proceeds** are grossed up by a factor of 1.3 (i.e. 130% of the relevant proportion of the proceeds is taxed).

The relevant proportion of the proceeds ensures that only the part that relates to the original expenditure that qualified for super-deduction is grossed up.

For example, the asset purchased may have contained expenditure that qualified for another first-year allowance (such as the special rate expenditure allowance of 50%), or which was pooled instead because it was a component that was not new and unused.

This ensures that the proceeds are effectively taxed at 24.7% (130% of the proceeds taxed at 19%), the same effective rate of relief that was obtained when the plant and machinery was purchased.

If the chargeable period ends on or after 1 April 2023, the proceeds are grossed up by a factor of $(0.3 \times \text{number of days in period before 1 April 2023} \div \text{total days in the period}) + 1$.

Mathematically, this means that if the plant and machinery is disposed of in an accounting period which falls wholly after 1 April 2023 (for example, the year ended 31 December 2024), there is no grossing up of the proceeds as they will be charged to corporation tax at 25% by then (or rather, it is assumed they will be – if the company has profits below £250,000 it will be taxed at a lower rate than this).

Example

A company with a year ended 31 January incurs expenditure on a large item of plant and machinery on 23 June 2021, paying £2,402,340. This includes expenditure which is not eligible for the super-deduction of £341,260 – the annual investment allowance is allocated to this expenditure.

A super-deduction of 130% of £2,061,080 ($2,402,340 - 341,260$) was claimed.

The item is sold on 5 October 2023 for total proceeds of £894,570.

What adjustments are made to the tax calculations as a result of the disposal?

Analysis

The relevant proportion of the proceeds related to the super-deduction asset is $(2,061,080 \div 2,402,340) \times £894,570$, i.e. £767,493. This means that the balance of £127,077 is allocated to the AIA part of the asset.

The disposal takes place in the year-ended 31 January 2024, of which 59 days fall before 1 April 2023. The factor to gross up the super-deduction proceeds is therefore $(0.3 \times 59 \div 365) + 1$, i.e. 1.048493.

There is therefore a balancing charge on the disposal of $(767,493 \times 1.048493)$ £804,712.

The balance of the proceeds identified above which does not relate to a super-deduction asset (£127,077) is deducted from the pool to which the expenditure that did not qualify for super-deduction was allocated.

50% first-year allowance

This is available for special rate expenditure (“SR expenditure”) which meets the common conditions above. The 50% FYA is known as an “SR allowance”.

Special rate expenditure includes expenditure on long-life assets, features integral to a building, cushion gas (the initial gas fed into a pipeline or other facility to enable the asset to start functioning) and solar panels.

The company is permitted to instead allocate the AIA to all or some of the expenditure on the asset and claim 100% on this.

Disposal of SR allowance assets (Clause 13)

A balancing charge will arise on the disposal of any SR allowance asset on the relevant proportion of the proceeds.

This is the proportion of the total disposal value based on the ratio of the original expenditure that qualified for the SR allowance divided by 2 (to compensate for the fact that the original allowance was only 50% of the qualifying cost), compared to the sum of:

1. The relevant SR expenditure, plus
2. Any expenditure on which any other first-year allowance was made, plus
3. Any other expenditure which was allocated to a pool for any chargeable period in respect of the asset (including any subsequent expenditure)

Any proceeds from the sale that are not attributable to the balancing charge are deducted from the appropriate capital allowances pool (almost certainly the special rate pool, although the legislation does not specify this, perhaps because part of the expenditure might have qualified for general pool allowances instead or because the company allocated AIA to part of the expenditure).

It is not possible to defer the balancing charge under s135(1) CAA 2001 (shipowners disposing of ships).

Example

A company with a year-end of 31 December purchased a special rate pool asset on 17 May 2021 for £2,140,000. It allocated its £1,000,000 annual investment allowance to the purchase and claimed a 50% SR allowance on the balance.

It disposes of the asset on 9 September 2024 for proceeds of £490,200.

Calculate the capital allowances and balancing charges for the years ended 31 December 2021 to 31 December 2024 assuming that the balance on the special rate pool at 1 January 2021 was £126,481.

Analysis

A table showing the detailed calculation is given on the next page.

| Year ended | AIA asset | FYA asset | Special Rate Pool | Total allowances |
|-----------------------------|------------------|--------------------|-------------------|------------------|
| <i>31 December 2021</i> | | | | |
| Balance b/fwd | | | 126,481 | |
| Addition | 1,000,000 | 1,140,000 | | |
| WDA | 6% | | (7,589) | 7,589 |
| AIA | 100% | <u>(1,000,000)</u> | | 1,000,000 |
| FYA | 50% | <u>(570,000)</u> | | 570,000 |
| | | 570,000 | | 1,577,589 |
| Transfer to SR pool | | <u>(570,000)</u> | 570,000 | |
| Balance c/fwd | | | 688,892 | |
| <i>31 December 2022</i> | | | | |
| WDA | 6% | | (41,334) | 41,334 |
| | | | 647,558 | |
| <i>31 December 2023</i> | | | | |
| WDA | 6% | | (38,853) | 38,853 |
| | | | 608,705 | |
| <i>31 December 2024</i> | | | | |
| Balancing charge (working) | | | | (130,567) |
| Disposal proceeds (working) | | | <u>(359,633)</u> | |
| | | | 249,072 | |
| WDA | 6% | | <u>(14,944)</u> | 14,944 |
| Balance c/fwd | | | <u>234,128</u> | |
| Balancing charge net of WDA | | | | (115,623) |
| Disposal working | | | | |
| Original SR expenditure | 1,140,000 | | | |
| Other expenditure | <u>1,000,000</u> | | | |
| | <u>2,140,000</u> | | | |

Balancing charge = disposal value x (SR expenditure ÷ 2) ÷ total expenditure
490,200 x 570000 ÷ 2140000 130,567

Disposal proceeds from SR pool (balance) 359,633
490,200

Anti-avoidance rule

Clause 14 provides for the counteraction of a relevant tax advantage from claiming a super-deduction or SR allowance, or avoiding a balancing charge on disposal.

This would be where the purpose, or one of the main purposes of the arrangements is to obtain a relevant tax advantage and either:

1. it is reasonable to conclude that the arrangements are, or include steps that are contrived, abnormal or lacking a genuine commercial purpose, or
2. it is reasonable to regard the arrangements as circumventing the intended limit of reliefs under CAA 2001, or otherwise exploiting its shortcomings.

It could be thought that if CAA 2001 had shortcomings, these should be fixed by amending the law rather than providing for them by an anti-avoidance rule.

100% first-year allowance (Clause 9(4))

This is available for expenditure that meets the common conditions above and is incurred in acquiring plant and machinery for use partly in a ring fence trade and partly for another qualifying activity, but not special rate expenditure.

The expenditure must be allocated between the ring fence trade (non-qualifying) and the other qualifying activity on a just and reasonable basis.

Extension of temporary increase in annual investment allowance (AIA)

As previously announced, Clause 15 extends the AIA limit of £1,000,000 to 31 December 2021.

Unless extended further, it will revert to £200,000 from 1 January 2022. For businesses and companies that do not have 31 December year-ends, this can create significant transitional issues in normal situations, but because of the availability of the super-deduction and 50% first-year allowance for special rate expenditure it will have less impact than normal for companies.

Example

A company has a year end 31 March 2022.

The total maximum AIA for the period will be $(£1,000,000 \times 275/365) + (£200,000 \times 90/365)$, i.e. $£753,425 + £49,315 = £802,740$.

For expenditure between 1 April 2021 and 31 December 2021, the actual maximum expenditure that can qualify for AIA is the £802,740. The policy paper issued as part of the Budget press releases indicates that the AIA for this period is limited to £753,425 which is at odds with its previous policy documents when the rates changed in the past. It also states that there are more detailed transitional rules for businesses subject to income tax, but we are not aware of any.

But the maximum expenditure that can qualify between 1 January 2022 and 31 March 2022 is only $(£200,000 \times 90/365)$ £49,315.

If the company incurred special rate expenditure of £750,000 on 31 December 2021 it would qualify for 100% AIA, saving (at 19%) £142,500 in corporation tax for the period. The company would likely prefer this to claiming a 50% SR allowance to which it would be entitled if there are no other assets against which the AIA would be better used.

If the expenditure is incurred on 2 January 2022, the business would only be able to claim an AIA of £49,315 AIA plus a special rate allowance on the balance of $50\% \times (£750,000 - £49,315)$ in first-year allowances, i.e. £399,658, which would only save £75,935 in corporation tax.

Getting the timing wrong would cost the company extra tax for its year ended 31 March 2022 of $(142,500 - 75,935)$ £66,565.

It would then receive 6% on the reduced balance of expenditure in the special rate pool in future years as seen earlier.

General decommissioning expenditure

Mining, oil and gas companies can claim a 100% capital allowance for qualifying decommissioning costs.

Clause 16 amends s163 CAA 2001 to include expenditure incurred in anticipation of the approval of an abandonment programme. This includes expenditure to preserve plant or machinery, the reuse or demolition of which is reasonable to assume will be required as part of the approved abandonment programme.

(New) s163A disqualifies some of the expenditure if the asset on which the expenditure is incurred is not included in an approved abandonment programme, or covered by a specific agreement, within 5 years of the end of the accounting period in which the expenditure was incurred.

Extensions of plant and machinery leases because of coronavirus

Lease extensions caused by Covid-19 could cause lessees to lose capital allowances under the long-funding lease rules. Clause 17 inserts s70YCA for situations where the change can be ignored.

S70YCA(2) will state that the usual rules on extensions will not apply, by election, where:

1. there is/was a change in the payments under the lease on or after 1 January 2020 that would have been payable on or before 30 June 2021 caused by coronavirus (the Treasury can change the 30 June 2021 date by regulation), and
2. the effect of which is to extend the term of the lease after the change, and
3. the consideration for the lease is substantially the same as, or less than, the consideration before the change, and
4. there are no other substantive changes to the terms of the lease, and
5. the lessor and lessee have not made any arrangement in connection with any changes to capital allowances as a result of the change in the lease payments

Condition 3. is the same wording used in the accounting amendment to IFRS 16 Leases when, as a concession, the lessee does not need to consider if the change in lease payments is a modification of the lease, but rather just recognise the reduction as a variable lease payment recognised in profit or loss.

‘Substantially the same’ is not defined and would therefore take its ordinary meaning. Often, in accounting terms, this means no more than 10% different and this would be a good rule of thumb to use for tax purposes as well.

S70YCA(3) provides that the anti-avoidance rules can be ignored, irrespective of whether the conditions in S70YCA(2) above are met, by election by either the lessor or the lessee under new s70YCA CAA2001. Any election binds the other party.

The elections are irrevocable and must be made within 21 months after the end of the period when the change in the payments under the lease were made. As well as notifying HMRC, the party making the election must also notify the other party and send a copy of the election sent to HMRC.

If a party to the lease makes or amends a tax return for a period in which the rentals were changed because of coronavirus, it must include any election made with the return (or amended return).

In practice, it is likely to be the lessee that makes the election to preserve its entitlement to capital allowances on the leased asset.