CHAPTER 11

CAPITAL ALLOWANCES – BASIC COMPUTATIONS

Statutory references in this chapter are to CAA 2001 unless otherwise stated.

11.1 Calculating capital allowances – the "general pool"

Capital allowances computations are prepared for accounting periods e.g. for the year ended 31 December 2010. Capital allowances are a trading expense for a business and should be **deducted in arriving at the trading profit figure** for the accounting period.

CAA 2001, s. 6

Year ended 31 December 2010:

	£
Adjusted profits before CAs	X
Less: capital allowances (CAs)	(X)
Trading profit	X

The trading profit (i.e. after CAs) would then be taxed in 2010/11 under CYB.

Individual CA computations are not necessary for every asset purchased. If so, this would be a horrendous exercise for large businesses who would be required to prepare a separate CA calculation for every piece of plant & machinery acquired.

Instead, **plant & machinery is usually "pooled"** into a "general pool" (also known as the "main pool") and **one computation is then prepared** based on the qualifying expenditure within the pool.

Plant & machinery allowances are a **fixed percentage** of the value of the pool, calculated on a **reducing balance basis**.

For accounting periods starting on or after 6 April 2008 the rate of CAs in the general pool is 20%.

CAA 2001, s. 56(1)

Having claimed capital allowances within the pool at the fixed rate, the residual balance in the pool ("the tax written down value") is then **carried forward as an opening balance** in the next accounting period where it will be written-down again.

Note: for the purposes of the illustrations and examples in this chapter we will ignore both First Year Allowances and the Annual Investment Allowance. These will be covered in the next chapter.

Illustration 1

Barney is a self-employed courier. He started trading on 1 April 2009 when he bought a new van for £18,750. This is the only plant & machinery used in his trade. He draws accounts annually to 31 March.

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The capital allowances computations will be:

	General Pool	CA claim
	£	£
Year ended 31 March 2010:		
Plant & machinery additions	18,750	
WDA @ 20%	(3,750)	3,750
Tax written down value c/fwd at 31.3.10	15,000	
Year ended 31 March 2011:		
Tax written down value b/fwd	15,000	
WDA @ 20%	(3,000)	3,000
Tax written down value c/fwd at 31.3.11	12,000	
Year ended 31 March 2012:		
Tax written down value b/fwd	12,000	
WDA @ 20%	(2,400)	2,400
Tax written down value c/fwd at 31.3.12	9,600	

Barney will claim the CAs via his self-assessment returns and the amounts claimed will be deducted from his adjusted trading profits.

11.2 General pool – additions and disposals

When a trader buys additional plant & machinery for use in his trade, this **"addition" must be brought into the CA computation**. Additions are brought in at cost.

Where the cost of an asset includes VAT:

1) If the trader is **VAT registered**, the VAT will be recoverable from HMRC. The addition should then be the **VAT-exclusive** amount.

2) If the trader is **not VAT registered**, he will not be able to recover the VAT from HMRC. The addition should then be the **VAT-inclusive** amount as the VAT will be a cost of acquiring the asset.

VAT registered businesses will produce accounts on a VAT-exclusive basis, so you will rarely have to adjust for the VAT.

When a trader **disposes of plant & machinery**, the disposal must be **taken out of the CA computation**. In this case we **deduct the sales proceeds** of the asset from the general pool and calculate writing down allowances on the balance.

Where **sales proceeds exceed original cost** (i.e. the trader sells some plant and makes a profit on the sale), the amount deducted from the pool is **restricted to original cost**. Effectively we cannot deduct more from the pool than we put in originally.

CAA 2001, s. 62

	General Pool
	£
Written down value (WDV) brought forward	X
Additions (at cost)	X
Disposals (sale proceeds – restricted to cost)	(X)
	X
Allowances @ 20%	(X)
Written down value (WDV) carried forward	X

Illustration 2

Daisy is a florist. She has traded for many years from a shop in Covent Garden. She draws accounts annually to 31 March. The tax written down value of the general pool at 1 April 2009 was £12,000.

Her recent capital acquisitions / (disposals) are as follows:

		£
1.10.09	New computer & printer	1,900
15.10.09	Sold old computer (original cost £800)	(100)
1.12.09	New front door for shop	2,000
1.5.10	New till	1,000
1.9.10	Additional shelving and racking in shop	5,000

The capital allowances computations will be:

	General Pool	CA claim
	£	£
Year ended 31 March 2010:		
Tax written down value b/fwd at 1.4.09	12,000	
Plant & machinery additions:		
New computer and printer	1,900	
	13,900	
Disposals:		
Old computer	(100)	
	13,800	
WDA @ 20%	(2,760)	2,760
Tax written down value c/fwd at 31.3.10	11,040	
Year ended 31 March 2011:		
Tax written down value b/fwd at 1.4.10	11,040	
Plant & machinery additions:		
New till	1,000	
Shelving and racking	5,000	
	17,040	
WDA @ 20%	(3,408)	3,408
Tax written down value c/fwd at 31.3.11	13,632	

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Note; the new front door on the shop is treated as part of the building under s.21 List A, so no plant & machinery allowances are given.

11.3 General pool – short and long accounting periods

Sometimes a trader may draw up accounts which are not for a 12-month period.

This will happen either:

a) when the individual **starts trading**; or
b) when the trader decides to **change** his accounts date.

The 20% writing down allowance **applies for a 12-month accounting period**. Therefore where a trader has an accounting period which is not 12 months long, this rate must be **scaled up or down as appropriate**.

Illustration 3

Jenny started trading on 1 March 2010. Her first set of accounts covered the period to 30 September 2010. Her only plant and machinery addition in the period was computer equipment costing £3,600.

The capital allowances computation will be:

	General Pool	CA claim
	£	£
7-months ended 30 September 2010:		
Plant & machinery additions:		
Computer equipment	3,600	
WDA @ 20% x 7/12	(420)	420
Tax written down value c/fwd at 30.9.10	3,180	

Illustration 4

Sanjay has traded for many years drawing accounts to 30 June. He decided to change his accounts date to 31 December and did so by drawing accounts covering the 18-month period from 1 July 2009 to 31 December 2010.

The tax written down value of the general pool at 1 July 2009 was £150,000. On 2 August 2009, Sanjay bought new machinery costing £30,000.

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The capital allowances computation will be:

	General Pool	CA claim
	£	£
18-months ended 31 December 2010:		
Tax written down value b/fwd at 1.7.09	150,000	
Plant & machinery additions:		
Machinery	30,000	
	180,000	
WDA @ 20% x 18/12	(54,000)	54,000
Tax written down value c/fwd at 31.12.10	126,000	

11.4 Future Proposals

In the second Budget of 2010 it was announced that the rate of Writing Down Allowance (WDA) for plant and machinery in the general pool will be reduced from 20% to 18% for accounting periods ending on or after 6 April 2012 (1 April 2012 for companies).

A hybrid rate of WDA will apply to a business whose accounting period spans 6 April 2012.

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11.5 When expenditure is "incurred"

CAA 2001, s. 5

When a trader acquires plant & machinery for use in his trade, he will receive capital allowances **in the accounting period in which the expenditure is "incurred"**.

The normal rule is that expenditure is "incurred" for capital allowances purposes on the **date on which the obligation to pay becomes unconditional**.

CAA 2001, s. 5(1)

The obligation to pay normally becomes unconditional on the date a contract is signed to purchase the plant and machinery. Therefore, in most cases expenditure is "incurred" when the contract is signed.

There is an **exception** to the general rule. If there is a gap of **more than four months** between:

CAA 2001, s. 5(5)

a) the date on which the **obligation to pay** becomes unconditional; and
b) the date on which **payment is required to be made;**

the expenditure is not "incurred" until the **date on which payment is required to be made**.

If some of the expenditure is required to be paid more than four months after the date on which the obligation to pay becomes unconditional and some is not, we must **split the expenditure** and **allocate it to separate accounting periods**.

Illustration 5

Jacob is a trader with a 31 March year-end.

He buys a new machine costing £100,000 for use in his trade. Under the terms of the contract he has to pay £75,000 one month after delivery of the machine and the balance of £25,000 five months after that.

He **signs a contract** to purchase the machine on **10 March 2010** and his obligation to pay becomes unconditional then.

He takes delivery of the machine on 21 March 2010. He is legally required to pay:

- £75,000 on 21 April 2010, and
- £25,000 on 21 September 2010.

The first payment is due **four months or less** after his obligation to pay becomes unconditional but the **second one is not**. He therefore "incurs" expenditure for CA purposes of:

1) £75,000 on 10 March 2010: and
2) £25,000 on 21 September 2010.

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Therefore:

1) £75,000 is a plant & machinery addition in the year ended **31 March 2010**: and
2) £25,000 is a plant & machinery addition in the year ended **31 March 2011**.

11.6 Hire purchase agreements and leasing

CAA 2001, s. 67

Expenditure on an asset acquired under a hire purchase contract is "incurred" at the **time when the asset is brought into use**. This is despite the fact that payment for the asset may be spread over several months or even several years. The **"4-month" rule does not apply to hire purchase agreements**.

Note that when an asset is acquired under a HP agreement, legal ownership of the asset transfers at the date the agreement is signed. Capital allowances can therefore be claimed.

Contrast this with a short leasing agreement (either an operating lease or a finance lease) whereby a trader is hiring / borrowing an asset from someone else. Here **capital allowances are not available, as the trader does not legally own the asset**. Instead relief is given for the leasing / hiring costs via the P&L account.

However, if the lease agreement is a **long funding** lease agreement as described earlier when we looked at common adjustments to profit, capital allowances are available to the lessee. We will look at these allowances in detail in a later chapter.

11.7 Claiming capital allowances

Capital allowances are not given automatically – they must be **claimed within the trader's individual self-assessment return** (or corporation tax return for a company).

A claim can be made at any time until the time limit for the amendment of the return - ie, by 31 January 2013 for a 2010/11 return.

11.8 Disclaiming capital allowances

There is no requirement for a trader to claim all of the capital allowances due to him. In some instances it **may be beneficial for a trader to disclaim some (or all) of his capital allowances**. This may be advantageous where a trader has low profits which may be covered by his personal allowances for the year.

If a trader disclaims capital allowances, this will lead to a **higher tax written down value being carried forward** which will, in turn, lead to higher capital allowances claims in future years.

Illustration 6

Paul is a self-employed window-cleaner. He draws accounts to 31 March. The tax written down value of the general pool at 1 April 2010 was £5,000. On 21 June 2010, he bought new ladders costing £1,000.

His tax-adjusted profits for the year ended 31 March 2011 are £5,200. He has no other income. The capital allowances computation will be:

	General Pool	CA claim
	£	£
Year ended 31 March 2011:		
Tax written down value b/fwd at 1.4.10	5,000	
Plant & machinery additions:		
Ladders	1,000	
	6,000	
WDA @ 20%	(1,200)	1,200
Tax written down value c/fwd at 31.3.11	4,800	

His 2010/11 trading income is therefore:

	£
Adjusted profits	5,200
Less: capital allowances	(1,200)
Trading Income	£4,000

This is covered by personal allowances for 2010/11 so no tax is payable.

Instead Paul could **disclaim his capital allowances**. The CA computation would now be:

	General Pool	CA claim
	£	£
Year ended 31 March 2011:		
Tax written down value b/fwd at 1.4.10	5,000	
Plant & machinery additions:		
Ladders	1,000	
	6,000	
WDA claimed	(NIL)	NIL
Tax written down value c/fwd at 31.3.11	6,000	

His 2010/11 trading income is now:

	£
Adjusted profits	5,200
Less: capital allowances	(NIL)
Trading Income	£5,200

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Again this is covered by personal allowances for 2010/11 so no tax is payable. However Paul now has a higher tax written down value to carry forward to 2011/12.

Example 1

Andy is a self-employed painter and decorator. He has a year-end of 30 September. The tax written down value of the general pool at 1 October 2009 was £8,000. On 25 July 2010, Andy bought new ladders for use in his trade costing £2,000. He sold his old ladders for £200.

Calculate Andy's capital allowances for the year ended 30 September 2010.

Example 2

Lynette started trading on 1 May 2010 making stained glass windows. She bought some machinery on 30 May 2010 for £10,000. On 1 November 2010 she signed a contract to buy a specialist cutting machine costing £14,000. She paid a 50% deposit on delivery on 20 November 2010 and the balance on 1 February 2011.

She drew her first accounts to 31 December 2010.

Calculate Lynette's capital allowances for the period ended 31 December 2010.

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Answer 1

The capital allowances computation will be:

	General Pool	CA claim
	£	£
Year ended 30 September 2010:		
Tax written down value b/fwd at 1.10.09	8,000	
Plant & machinery additions:		
New ladders	2,000	
	10,000	
Disposals:		
Old ladders	(200)	
	9,800	
WDA @ 20%	(1,960)	1,960
Tax written down value c/fwd	7,840	

Answer 2

	General Pool	CA claim
	£	£
8–months ended 31 December 2010:		
Plant & machinery additions:		
Machinery (May 2010)	10,000	
Cutting machine (November 2010)	14,000	
	24,000	
WDA @ 20% x 8/12	(3,200)	3,200
Tax written down value c/fwd	20,800	

Notes:

1. Balance of payment on cutting machine within 4 months of signing contract, so all expenditure deemed to be incurred on 1 November 2010.

2. 8 month AP, therefore restrict WDAs.

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