

## **Major changes to capital allowances**

In his last Budget speech, Gordon Brown announced certain changes to capital allowances for plant and machinery and to Industrial Buildings Allowances and Agricultural Buildings Allowances.

Although many of the rules are not yet finalised, we now know a lot more about how the changes will operate and felt we should keep you abreast of developments.

### **Summary of the changes to capital allowances for plant and machinery**

On a positive note, the 50% first year allowance (FYA) for small businesses and 40% FYA for medium sized businesses continue to be available for expenditure incurred on plant and machinery before 6 April 2008 for the self employed or 1 April 2008 for companies. However, major changes are proposed for 2008/09 and these are outlined below:

- the rate of writing down allowance (WDA) for plant and machinery will be reduced from 25% to 20%;
- the rate of WDA on long-life asset expenditure will increase from 6% to 10%;
- the rate of WDA on certain fixtures integral to a building, such as central heating, lighting and air conditioning, will be set at 10%; and
- a new Annual Investment Allowance (AIA) will be introduced for the first £50,000 of expenditure on plant and machinery.

Obviously, a reduction in the WDA for plant and machinery and, in particular, the changes to the WDA for certain fixtures integral to a building, is generally bad news for businesses.

### **What is the AIA?**

The AIA will apply to expenditure incurred on plant and machinery on or after 6 April 2008 for the self employed or 1 April 2008 for companies. It will not be available for expenditure on cars but will be available for most types of plant and machinery, including integral fixtures.

The annual allowance will be £50,000 per 12 month period and all qualifying expenditure up to that level will qualify for a 100% allowance. Anything over that will fall into the normal capital allowance pools at either 10% or 20%.

However, as the AIA only applies to expenditure incurred from next April onwards, an apportionment of the £50,000 limit may be required if the accounts year straddles April

2008. For example, a company with a 31 December 2008 year end will only be entitled to an AIA of £37,500 ( $9/12 \times £50,000$ ).

### **Am I a winner or a loser?**

This depends on how much you spend and what you spend it on. For example, if you spend £10,000 per annum on plant, then you will be a winner. Currently, a small business would obtain a 50% FYA (£5,000) but then have to write the balance off at 25% per annum in future years. With the AIA, all of the £10,000 would be fully written off in year one.

However, if you spend £200,000 on air conditioning, you will be a loser. Currently, a medium sized business would receive a 40% FYA (£80,000) and then a 25% WDA per annum in future years. Under the new rules, the AIA will only amount to £50,000, with a 10% WDA on the balance of £150,000. This would give total capital allowances for the year of £65,000, being £50,000 AIA plus £15,000 WDA.

What these simple examples illustrate are two things in particular:

- the timing of the expenditure either pre or post April 2008 may have a significant effect on your taxable business profits; and
- together we need to ensure that all your capital allowance claims are up to date by April 2008 and that all possible items are included in what will become the 20% 'pool' of plant and machinery.

The rules are complex but we would be delighted to help you plan the most effective way of coping with the changes.

### **Summary of the changes to Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs)**

There are two major changes to both IBAs and ABAs:

- from 2008/09 WDAs on industrial buildings (including hotels) and agricultural buildings will be gradually phased out, with final withdrawal of both regimes by April 2011; and
- to prepare the way for final abolition, most balancing adjustments (which, for example, can arise on the sale of an IBA or ABA) are generally withdrawn from 21 March 2007.

Whilst some businesses may benefit from the second change if they sell an IBA or ABA in the near future (there will be no claw back of allowances previously given), the first change is bad for all businesses concerned.

The rates of WDA are to be reduced over the period from April 2008 to April 2011 when the allowances will disappear. The value of the WDAs (either 4% of original cost or the recalculated entitlement following a purchase/sale) will be reduced as follows:

- 75% of entitlement in 2008/09;
- 50% of entitlement in 2009/10; and
- 25% of entitlement in 2010/11.

**So what do I do now?**

These changes are fundamental to many businesses. Please get in touch with us as soon as possible to discuss how we can maximise any allowances for your business.