5. Allowances and charges

5.1 Introduction

5.1.1 Overview

The main content of this chapter is an illustration of the various different types of allowance for plant and machinery, but it also addresses some more difficult scenarios and shows how effect may be given to allowances and balancing charges. First-year tax credits are dealt with at **5.11**.

5.1.2 Choosing the correct type of allowance

The writing-down allowance (WDA) may be seen as the default allowance for plant and machinery. However, the rate of tax relief may in certain circumstances be accelerated by claiming a first-year allowance (FYA) or an annual investment allowance (AIA).

As a general principle, a business will wish to claim allowances as fast as possible. This will involve maximising any claims for FYAs or AIAs, and ensuring that assets attracting a slower rate of WDA will as far as possible be the subject of a claim to accelerated allowances instead. If, for example, a business buys both integral features and general plant and machinery in the same period, it will normally wish to claim AIAs against the integral features.

Example

A particular business is entitled to maximum AIA in the period of £25,000 (perhaps because other connected companies have absorbed the balance of the AIA to which it would have been entitled). For simplicity, say that the business incurs exactly £25,000 of expenditure on integral features and the same level of expenditure on other plant and machinery.

If it claims AIAs on the integral features, its total claim will be £29,500, consisting of AIA of £25,000 and WDAs of £4,500 (calculated as £25,000 at 18%).

If it instead claims AIAs on the other plant and machinery, the AIA figure of £25,000 will remain unchanged. However, the WDAs on the integral features will be calculated at just 6% (for periods beginning from April

2019), giving a figure of £1,500. In this case, the total claim for the year will therefore be just £26,500.

The difference is (in principle, at least) one of timing only, and the future allowances in the second scenario will be higher to compensate for the initial disadvantage.

Exceptionally, a business may wish to claim a lower rate of capital allowance. This could arise, for example, if personal allowances will be lost for a sole trader or if a company wishes to maximise losses in a future year to offset against other profits.

Businesses owning fixtures need to claim allowances before selling the property; failure to do this will deny allowances to any future owner (and will thus potentially depress the value). This is explored in detail at **Chapters 12 to 14** below.

Guidance: CA 23100*ff*.

5.1.3 Final chargeable period

Various special rules apply to the final chargeable period, and the legislation contains a formal definition of that term.

For the main pool, or for a special rate pool, the final chargeable period is the chargeable period in which the qualifying activity is permanently discontinued.

For a class pool under s. 107 (overseas leasing), the term denotes the chargeable period at the end of which there can be no more disposal receipts in any subsequent chargeable period.

The definition of the term for the purposes of a single-asset pool is more complicated. The normal rule is that it is the first chargeable period in which any disposal event given in s. 61(1) occurs: see **5.5.2**. However, there is no final chargeable period:

- just because plant or machinery starts to be used partly for other purposes (s. 206(4): see **5.8**);
- at the relevant cut-off for a short-life asset (s. 86(2) and s. 87(2): see **15.3**); or
- for a single ship pool (s. 132(2): see **Chapter 20**).

Law: CAA 2001, s. 65

5.2 Annual investment allowances

5.2.1 Introduction

The annual investment allowance (AIA) gives immediate tax relief for certain types of expenditure, up to a defined limit. It is available for most capital expenditure on plant and machinery.

Example 1

Jack runs an independent bookshop. During a particular accounting year he incurs just two items of capital expenditure: a shelving unit costing £10,000 and a new till for £600.

Jack claims AIAs on the combined total of £10,600. His taxable profits for the year are reduced by the full amount of the £10,600. (If he has capital expenditure from earlier years, on which he has not yet had full tax relief, he may be entitled to WDAs on that other expenditure as well. He cannot, however, claim AIAs this year for expenditure incurred in the past.)

AIAs may be claimed by businesses of any size. As, however, there is a cap on the amount of AIA that may be claimed in any year, and as associated businesses generally have to share a single allowance (see **5.2.10** and following paragraphs below) the allowance is of less benefit to the largest businesses and to businesses that are part of larger groups of companies.

The key conditions for claiming AIAs are that the person concerned must incur "AIA qualifying expenditure" (see **5.2.2**) and must own the plant or machinery at some time during the chargeable period for which the claim is made.

An AIA can only be made for the chargeable period in which the expenditure is incurred (one of the many things that went wrong for the ill-advised taxpayer in *Tevfik*). It cannot be used for expenditure incurred in an earlier period, whether or not other allowances have already been claimed on that expenditure.

Example 2

Deborah spends £20,000 in June 2018 on some fixtures in her office. She only becomes aware in November 2022 that the can claim plant and machinery allowances on those fixtures. She draws accounts up to 31 December.

As long as she still owns the fixtures in question, Deborah may make a capital allowances claim for a later year – perhaps for the year to 31

December 2021 or by amending the return for the previous year. However, she will be able to claim WDAs only, as the AIA claim was only possible for the year in which she actually incurred the cost. Unless her accounts are under HMRC enquiry, it is too late now for Deborah to change her claim for the year to 31 December 2018.

Example 3

Donna has a balance brought forward on her capital allowances pool of £6,000. She incurs no new expenditure in the year. She is not entitled to claim AIAs on the £6,000 as the expenditure is not incurred in the later year.

Subject to the overall limits for the year in question (see **5.2.4** below), the person claiming the AIA may claim in respect of all of his qualifying expenditure or in respect of only part of it, as he chooses. If an AIA claim converts a profit to a loss, or augments an existing loss, the full amount of the loss may be relieved in the usual way.

A person might choose to claim a lower amount of AIA to avoid loss of the personal income tax allowance, for example. As a point of practice, the allowance may also be partly disclaimed so as to negate a balancing charge that would otherwise arise.

Example 4

Eddie buys a new van for £14,000 and sells his old one for £6,000. The value of the main pool at the start of the year was just £4,500. Eddie may claim AIAs of £14,000 and take the balancing charge of £1,500. Or he may reduce the AIA claim to £12,500, adding the balance of £1,500 to the main pool to ensure that no balancing charge arises. There is no tax difference.

Law: CAA 2001, s. 51A
Case: *Tevfik v HMRC* [2019] UKFTT 600 (TC)
Guidance: CA 23080*ff.*

5.2.2 AIA qualifying expenditure

AIAs are given only for "AIA qualifying expenditure". This means that the expenditure on the plant or machinery must be incurred by an individual, a partnership whose members are all individuals, or by a company.

It follows that partnerships with a corporate member may not claim AIAs. The *Hoardweel Farm Partnership* case concerned a claim for AIA where a partnership had a corporate partner. The decision was primarily one of fact, as it was argued that the corporate partner had been dormant. However, the business accounts indicated that the company had used a partnership capital account and AIAs were denied.

Another partnership argument was raised in *Drilling Global Consultant*, though it never stood any real chance of success. The case concerned a limited liability partnership and the appellant contended that the LLP, with its corporate member, should be regarded as a company; reference was made to various sections of CTA 2009 dealing with the nature of partnerships. On this basis, it was contended that the LLP was a qualifying person for the purposes of claiming AIAs. It was also suggested that there was no good reason to exclude mixed partnerships from claiming AIAs. And it was argued that, in reality, there was no partnership. None of these arguments prevailed, however: the person claiming the allowance was not a qualifying person and HMRC's stance could not be successfully challenged.

Partnerships with a partnership as a member are also denied AIAs. This, at least, appears to be the correct interpretation of the rules and was the line HMRC take, according to a query considered in *Taxation* magazine of 25 September 2013. It had been argued that the second partnership could be looked through by virtue of ITTOIA 2005, s. 863, which states that, for income tax purposes, "all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such)".

AIAs are not available for trusts, or for partnerships with a trust as a member.

Although there are a few "general exclusions" (see **5.2.3** below), the AIA is available for a wide range of expenditure. Specifically, AIAs may be claimed on the cost of integral features and other special rate expenditure, as well as on expenditure on general plant and machinery. AIAs are thus available for all vehicles except cars, for fixtures in property, business machinery, office equipment, etc.

Law: CAA 2001, s. 38A

Cases: *Hoardweel Farm Partnership v HMRC* [2012] UKFTT 402 (TC); *Drilling Global Consultant LLP v HMRC* [2014] UKFTT 888 (TC)

Guidance: CA 23084

5.2.3 General exclusions

Expenditure is not AIA qualifying expenditure if a claim is precluded by any of the following “general exclusions”:

- expenditure incurred in the chargeable period in which the qualifying activity is permanently discontinued (see below);
- expenditure on a car (see **9.2** for the definition used for these purposes);
- certain expenditure incurred for the purposes of a ring-fence trade;
- expenditure incurred in connection with a change in the nature or conduct of another person’s trade or business, where the obtaining of an AIA is a main benefit;
- where an item of plant or machinery provided for other purposes starts to be used for the qualifying activity;
- use for other purposes of plant or machinery provided for long funding leasing; or
- where an asset has been received as a gift (s. 14).

There is one possible exception to the above, where there is pre-trading expenditure on mineral exploration and access.

In contrast to the rules for FYAs (see **5.4.2**) there is no general exclusion for leased assets. This is a deliberate policy difference and was spelt out in the original *Budget Note* that introduced the AIA in 2008 (BN12, para. 18).

Most of the exclusions are self-explanatory, but the fourth bullet requires more explanation. This is obviously an anti-avoidance measure, designed to prevent a person from multiplying his entitlement to AIAs. HMRC have illustrated the way it might work as follows.

HMRC example

Smithson Plc is a business that has already used up its AIA for its current chargeable period. It wants to buy a lathe for £50,000. It makes a loan of £50,000 to Dan, a higher rate taxpayer, who buys the lathe for his new qualifying activity of operating the lathe, thus obtaining the AIA, with fixed supply and sale contracts with Smithson Plc. The lathe is installed in Smithson Plc’s factory and operated by its workforce on a subcontract basis. The tax saving is shared by Smithson Plc and Dan through the contract price.

The anti-avoidance legislation means that Dan is not entitled to the AIA and so the scheme does not work.

Law: CAA 2001, s. 38B

Guidance: CA 23084

Permanently discontinued

The question of whether a trade has been permanently discontinued is one of fact, and there are no special capital allowances rules to determine the matter. Nevertheless, the point was considered in the context of the AIAs in *Keyl v HMRC*. The taxpayer had transferred his business as a going concern to a company, and that represented a permanent discontinuance of the trade he had previously carried on. The tribunal held that the unincorporated trade had ceased on 31 March, and that the new trade in the company had begun on 1 April:

> "In the scintilla of time before midnight on 31 March 2009 Mr Keyl's trade ceased. In the scintilla of time after midnight, CC Ltd commenced its trade."

Given the above finding of fact, it followed that the trade was permanently discontinued in the earlier chargeable period, and no AIAs were available for that period. The decision was subsequently upheld by the Upper Tribunal, which ruled that "a discontinuance of a trade at the end of a chargeable period is a discontinuance of that trade in that period". This is therefore an important consideration for a sole trader or partnership that is intending to incorporate, and care should be taken if significant expenditure is being incurred. See **18.5.4** for a detailed discussion of connected party transactions, including the question of elections under sections 198 and 266.

Case: *Keyl v HMRC* [2014] UKFTT 493 (TC), [2015] UKUT 383

5.2.4 Amount of annual investment allowance

The AIA was only introduced in 2008 but the amount of relief that may be given in any one year has already fluctuated wildly. The maximum AIA for corporation tax purposes has been as follows since that time: