

A hand holding a magnifying glass over a document. The document has the title 'Capital Allowances' and some text below it, including 'DISCRIMINATION UNDER THE EMPLOYMENT (AGE) REGULATIONS 2006'.

Capital Allowances

Capital Allowances - Making the Most of the New Regime

2008/9

TABLE OF CONTENTS

Finance Act 2008	3
First year allowances (FYAs)	4
Annual investment allowance (AIA).....	6
Writing down allowance (WDA).....	9
Integral features.....	11
First year tax credits	13
The new £1,000 write-off	15
Fire safety expenditure	17
Industrial buildings allowances (IBAs).....	18
Summary of changes	21

A publication by:

Indicator

Calgarth House, 39-41 Bank Street,

Ashford, Kent, TN23 1DQ

Tel.: (01233) 653500

Fax: (01233) 647100

E-mail: subscriptions@indicator.co.uk

editorial@indicator.co.uk

www.indicator.co.uk

Registered in England

Company Registration No. 3235138

Editor-in-Chief: Duncan Callow, Solicitor

Editor: Martin Attis

Publishing Director: Peter Bosschem

First Edition - First Print - E01P1

© 2008 Indicator Limited. No part of this publication may be reproduced or transmitted in any form or by any means or stored in any retrieval system without permission. Every effort has been made by Indicator Limited to ensure that the information given is accurate and not misleading, but Indicator Limited cannot accept responsibility for any loss or liability perceived to have arisen from the use of any such information. Only Acts of Parliament and Statutory Instruments have the force of law and only the courts can authoritatively interpret the law.

FINANCE ACT 2008

What's changed?

The **Finance Act 2008** (FA 2008) is the latest initiative in the government's reform of business taxes. The stated objective at the time it was announced was to come up with a package to promote investment and growth in small businesses with *"more generous and better focused incentives for investment"*.

A major package of capital allowances reforms has arrived for 2008/9. These include:

- the abolition of 50% and 40% first year allowances (FYAs) for small and medium sized businesses
- a new 100% annual investment allowance (AIA) for the first £50,000 of expenditure incurred each year on most types of plant
- a reduction in the main rate of writing down allowance (WDA) for plant and machinery from 25% to 20%
- the introduction of a special rate of WDA of 10% for certain "integral features" within buildings
- a repayable first year tax credit for expenditure (by companies only) on energy saving and environmentally beneficial plant and machinery qualifying under the enhanced capital allowances regime
- the ability to fully write-off small plant and machinery pools
- extending 10% plant allowances for adding thermal insulation to all commercial buildings
- the repeal of the rules that treat certain fire safety works as plant and machinery
- the abolition of industrial buildings allowances (IBAs), enterprise zone allowances (EZAs) and agricultural buildings allowances (ABAs).

FIRST YEAR ALLOWANCES (FYAs)

What are FYAs?

FYAs for plant and machinery have been introduced on various occasions in the past in order to accelerate the tax relief available compared to conventional writing down allowances (WDAs). Generally, FYAs have been used to encourage investment in certain types of asset, including, for example, energy efficient or environmentally friendly plant. Other than these, FYAs at 50% were available for expenditure incurred between April 2006 and April 2008.

What's changed?

The full FYA will still be available for expenditure incurred on or before March 31 2008 (companies) and before April 5 2008 (for non-companies) even if your accounting period overlaps that date. The FYA does not have to be time-apportioned. Your expenditure after this date will not attract FYAs, but falls within the rules for a new £50,000 annual investment allowance (AIA) (see **Chapter 3**).

TAX TIP

Given that we have already gone past April 2008, the only choice you have to make now is whether or not you incur expenditure in your current accounting period or defer it until the start of your next one. Yes, this will defer the relief for a year but it may mean that the full £50,000 AIA is available.

Example

Let's say you have accounting year-end of December 2008 and have £50,000 in your budget to spend on plant. If you spend the money in October 2008, there is no FYA and the AIA is proportionately restricted to only 9/12 of the annual amount (April to December 2008), that is £37,500. If, however, you carry your budgeted spend forward to January 2009 (i.e. the first month of a new accounting period), the full £50,000 of AIA is available (albeit that the tax relief would effectively be delayed for a year).

Are there any incentives for going green?

Businesses purchasing designated plant and machinery which is energy efficient, reduces water use or improves water quality, are entitled to enhanced capital allowances (ECA) schemes which write off 100% of the cost against taxable profits of the period during which the investment was made.

The qualifying technologies are published in the Energy Technology Criteria List and the Water Technology Criteria List. These lists can be found at <http://www.eca.gov.uk>. Following this year's review by Defra the following are being added:

- wastewater and recovery
- compressed air master controllers
- compressed air flow controllers
- heat pump dehumidifiers
- white LED lighting.

TAX TIP

New lists will be published later in 2008. Once these have been published a Treasury Order will link them to the schemes. The lists are available at <http://www.eca.gov.uk> so it's worth visiting to see if your expenditure qualifies for ECAs.

What about cars?

A 100% FYA is available for expenditure on cars with low CO₂ emissions. This was due to expire on March 31 2008, but has now been extended by five years to March 31 2013. To qualify as a low emissions car it must be registered either: **(1)** between April 17 2002 and March 31 2008 and emit not more than 120g/km of CO₂; **(2)** between April 1 2008 and March 31 2013 and emit not more than 110g/km of CO₂; or **(3)** be electrically propelled. (**Note.** Cars under leasing contracts existing at April 1 2008 are unaffected by the reduction in qualifying emission level to 110g/km.)

KEY POINTS

1. 100% FYAs bring forward the time tax relief is available by enabling you to claim relief on the full cost of an asset against your profits for the year in which the investment is made.
2. With the introduction of the AIA consider whether to incur your expenditure in your current accounting period or to defer it until the start of your next one. This will defer the relief for a year but may mean that the full £50,000 AIA is available.
3. Claim enhanced FYAs for energy efficient plant rather than waste AIA that could be put against other expenditure.
4. If it's time to replace a vehicle, consider looking seriously at a low emissions car, because of the tax breaks it brings. However, your choice might be limited because although there is a healthy list of cars coming up to the old 120g/km emissions mark, manufacturers will need time to respond to the new 110g/km threshold.

ANNUAL INVESTMENT ALLOWANCE (AIA)

So what's new?

In April 2008 a new annual investment allowance (AIA) was introduced. For SMEs this replaces the existing 50% and 40% FYAs. The stated intention of the AIA is to encourage greater levels of investment by reducing the cost of capital. The government claims that 95% of businesses invest less than £50,000 a year. How much do you plan to spend in total for 2008/9?

In contrast to the FYAs it is replacing, the AIA is available to all businesses, regardless of size or legal form. It includes: sole traders, companies, partnerships between individuals, registered friendly societies and certain corporate bodies that are not companies, but are within the charge to Corporation Tax.

Also, in contrast to the abolished FYAs, the AIA will be available to landlords, as there is no exclusion from AIA of expenditure on fixtures in a let building.

How does the AIA work?

The AIA provides for a 100% capital allowance on the first £50,000 of expenditure on plant and machinery each year (but not necessarily the earliest purchases). The person incurring the expenditure must own the plant as a result of incurring the expenditure. The effective value of the AIA is therefore £50,000 multiplied by your marginal tax rate. Remember that this is merely an acceleration of the tax deduction that would be available via "ordinary" capital allowances.

What can we use it for?

The AIA can be offset against virtually all plant and machinery expenditure (excluding cars), including fixtures and so-called "integral features".

The government's stated intention was to take a light approach to the targeting of the AIA so that it would be an effective investment incentive. The advantage of this is that: (1) individual companies each receive a single annual allowance; (2) groups of companies, companies under common control and related companies receive a single allowance, which they may allocate amongst themselves if they wish. That is to say, if a group consists of two companies, one of them may use the whole of the £50,000 AIA; you are not forced to split it £25,000 each.

The AIA can be allocated to expenditure which would otherwise qualify for lower rates of relief, e.g. in the first instance to integral features normally qualifying for 10% WDAs.

Example

Let's say you incur the following expenditure: (1) £23,000 on integral features qualifying for 10% WDAs; (2) £17,000 on environmentally beneficial equipment qualifying for enhanced capital allowances (i.e. 100% AIA); and (3) £76,000 on other plant and machinery additions to the general pool qualifying for 20% WDAs. What's the most tax efficient way of allocating your AIA to this lot? Leave the £17,000 on environmentally beneficial plant to qualify for 100% FYAs on its own account. This preserves your AIA for first allocating it against £23,000 integral features expenditure and then the remaining £27,000 of it against the plant otherwise qualifying for only 20% WDA. This leaves £49,000 (£76,000 - £27,000) of general pool plant qualifying at 20%. By prioritising things this way you have converted the 10% allowance on integral features into a 100% allowance and done the same for the 20% allowance on general pool expenditure.

TAX TIP

Although £50,000 will not purchase much in the way of integral features, freedom to allocate the AIA as you see fit means that your business should be able to avoid the special 10% rate pool by allocating that expenditure against the AIA allowance. And unused AIA can't be carried forward to the next period, so use it or lose it is the motto.

Could we claim enhanced allowances as well?

Technically, you could claim both AIA and enhanced FYAs on energy efficient plant. Unfortunately, the Taxman has foreseen this and the legislation includes a provision which means you have to decide which to claim.

TAX TIP

Claim enhanced 100% FYAs for energy efficient plant rather than waste AIA that could be put against other expenditure.

What if our accounting period isn't for twelve months?

The bad news is that where your accounting period is less than a year, then the maximum AIA is proportionately reduced. The good news is it's increased if it's more than a year. Similarly, as this is its first year, AIA is time apportioned where your accounting period overlaps April 2008. This is calculated by using the precise number of days on either side of April 2008, e.g. a company with a September 30 2008 year-end will be entitled to AIA for the chargeable period of £25,000 (i.e. $183/366 \times £50,000$). So where your accounting period straddles April 2008:

- pre-April 2008 expenditure will qualify for FYAs under the old rules at either 50% or 40%
- post-April 2008 expenditure will qualify for capital allowances under the new AIA rules. The £50,000 threshold will be restricted depending on the number of months in your accounting period which fall after April 2008.

Example

If your company has a December 2008 year-end, your AIA is restricted to £37,500 ($9/12 \times £50,000$). Expenditure in excess of the AIA limit will be available for capital allowances at 10%, 20% or hybrid rates.

What happens when we sell the asset?

Where AIA is claimed on an asset which you later dispose of (sell, scrap, demolish etc.), the proceeds need to be brought into your capital allowances calculation for that year. This is done by reducing the value of as yet unclaimed expenditure via WDAs by a similar amount.

KEY POINTS

1. The Finance Act 2008 introduced a new annual investment allowance (AIA) for the first £50,000 of expenditure on most plant and machinery each year. You can claim the new AIA on long life assets and integral features as well as on general plant and machinery.
2. Where you spend more than £50,000 in any chargeable period, any additional expenditure will be dealt with under the normal capital allowances regime, entering either the special rate or main pool, where it will attract WDAs at 20% or 10%.
3. Unused AIA will be lost; you can't carry it forward to be used next year. So make sure you work out your total AIA for the 2008/9 transitional year and use it up if you can.
4. The bad news is that where your accounting period is less than a year, then the maximum AIA is proportionately reduced. The good news is it's increased if it's more than a year.
5. You are free to allocate AIA to any assets you choose. So, for example, you can avoid the special 10% rate pool by allocating that expenditure against the AIA instead.
6. Claim enhanced 100% FYAs for energy efficient plant rather than waste AIA that could be put against other expenditure.

WRITING DOWN ALLOWANCE (WDA)

What is now the main rate for WDA?

Capital allowances allow your business to write off the cost of capital assets, such as plant and machinery, against its taxable income. They take the place of annual depreciation, which is not allowed for tax. On or after April 1 2008 (for Corporation Tax), or after April 6 (for income tax), the rate of WDA is 20% p.a. on all general plant and machinery, with 10% p.a. for "special rate" plant and machinery. Both are on a reducing balance basis.

For many years the standard rate of WDA for plant and machinery has been 25% p.a. on a reducing balance basis. However, from April 2008 this has been reduced to 20%. In calculating the rate of WDAs available for 2008/9, the date the expenditure is incurred is irrelevant. However, if your financial year overlaps March 31 2008 (Corporation Tax) or April 5 2008 (income tax) a "hybrid" rate of WDA is used, determined on the basis of time apportionment.

What is this "hybrid" rate for 2008/9?

It is arrived at by calculating the proportion of your period before and after the date the rates changed.

Example

If a company's chargeable period starts on January 1 2008 and ends on December 31 2008, the calculation of the hybrid rate of WDAs will be as follows: $91 \text{ days}/366 \text{ days} \times 25\% = 6.22\%$, plus $275 \text{ days}/366 \text{ days} \times 20\% = 15.03\%$. Therefore the total hybrid rate for the transitional period is 21.25%.

The table below lists the possible hybrid rates of WDA for financial years that overlap March 31/April 5

FINANCIAL YEAR ENDED	HYBRID RATE OF WDA
March 31 2008	25.00%
April 30 2008	24.58%
May 31 2008	24.17%
June 30 2008	23.75%
July 31 2008	23.33%
August 31 2008	22.92%
September 30 2008	22.50%
October 31 2008	22.08%
November 30 2008	21.67%
December 31 2008	21.25%
January 31 2009	20.83%
February 28 2009	20.42%
March 31 2009	20.00%

What about WDA on cars?

Capital allowances on cars costing more than £12,000 (so-called "expensive cars" but excluding low emissions cars) have, for many years, been put into their own separate capital allowance pool (single asset pools). There is no FYA on most cars and the annual WDA is restricted to a maximum of £3,000 for these cars. Following the reduction in the annual rate of WDA from 25% to 20%, this cap should have reduced to £2,400 (being 20% x £12,000).

However, since the regime for capital allowances on cars is expected to change to one based on CO₂ emissions in 2009, we understand that the £3,000 limit will remain for existing cars for this final year (2008/9); £12,000 will remain the trigger for a single asset pool. However, a new car costing, for example, £14,000 would get a full 20% WDA of £2,800 this year. Instead, the WDA on a car costing more than £12,000 has been kept at a maximum of £3,000 p.a.

What's in the pipeline?

We are expecting the capital allowances regime for cars to change in April 2009. The proposed new rules are based on environmental objectives. For example, giving 20% WDAs on cars with CO₂ emissions of between 111g/km and 165g/km by simply lumping them in with the general plant and machinery pool. We may also see a new pool with a lower WDA rate for cars with CO₂ emissions exceeding 165g/km.

Isn't there a new 10% rate for special assets?

The rate of WDA for a new special rate pool of expenditure is 10% on a reducing balance basis. For most assets, this represents a significant reduction from the standard rate of 25% previously available. So which elements of your expenditure could end up with this 10% rate?

The definition of special rate expenditure includes expenditure on thermal insulation of buildings and integral features (see **Chapter 5**). For an asset already held on April 2008, expenditure before and after the date is treated as being upon separate items of plant and machinery.

Capital allowances on the thermal insulation of buildings (excluding residential property) will be restricted to the 10% rate for expenditure added to the new special rate pool.

Isn't there an existing tax deduction for landlords?

Residential property businesses may instead qualify for the £1,500 per dwellinghouse landlord's energy saving allowance for the following insulation types: cavity wall, loft, solid wall, hot water system, draught proofing and floors.

KEY POINTS

1. Make sure new expenditure is covered by your AIA for capital allowances purposes, rather than falling into new special rate pools. This way you'll get a 100% tax deduction straight away.
2. For existing assets, check your capital allowances computation this year to make sure the rates being used have changed. It's complicated in this transitional period from old to new rates, with a hybrid percentage unique to you, being used.
3. WDA rates will settle down next year with, for example, WDAs at 20% not 25%. But look in your tax computations for the creation of a special 10% rate pool this year.
4. The WDA on a car costing more than £12,000 is restricted to £3,000 a year. It is not reduced to 20% of £12,000 in line with the rate of WDA.

INTEGRAL FEATURES

What's new with integral features?

FA 2008 provides for a new classification of integral features of a building which will be allocated to a new special rate pool and will attract WDAs at only 10% p.a.

What are integral features?

Integral features that will get this 10% WDA are listed in the legislation as:

- electrical systems (including lighting systems)
- cold water systems
- space or water heating systems, powered systems of ventilation, air-cooling or purification and any floor or ceiling comprised in such systems
- lifts, escalators, moving walkways
- external solar shading.

However, assets whose principal purpose is to insulate or enclose the interior of a building or to provide a pavement floor, wall and ceiling are excluded.

What happens if we repair or replace an asset?

When the whole or the majority (more than 50%) of an integral feature is replaced, that expenditure also goes into the special rate pool.

The catch is that if the expenditure on the integral feature (including repairs) is more than 50% of the cost of replacing it, it will be treated as being a capital replacement. In essence, the usual debate over whether expenditure is capital or revenue for tax purposes is reduced to a 50% test.

Example 1

Repairs costing 50% of the cost of a heating system could be allowed as repairs, but if the figure were 50.1%, they would automatically be capital.

Example 2

You decide to overhaul the heating system in your offices. The original system cost £18,000. An engineer advises that you could either: (1) replace the entire system at a cost of £36,000; (2) replace the boilers, pumps and some thermostatic valves and pipe work at a cost of £20,000; or (3) just replace the boiler at a cost of £9,000.

The first option will be treated as a capital replacement qualifying WDAs at 10% p.a. The second option will also be treated as a capital replacement qualifying for WDAs at 10% p.a. (because the works in this case cost more than 50% of the cost of a full replacement, i.e. £36,000). Note that the original cost of the asset to be replaced is irrelevant. However, the third option could be allowed as repairs because it cost less than 50% of the £35,000 full replacement cost.

No guidance has been provided by HMRC as to how this integral features system will be monitored, or what evidence you need to keep showing what the cost of your alternatives were.

TAX TIP

Minor replacements are unlikely to cause difficulty because they cost substantially less than replacing an entire integral feature. However, for substantial works, obtain third party evidence of cost.

KEY POINTS

1. Make sure expenditure is covered by your annual investment allowance for capital allowances purposes, rather than falling into the 10% pools. This way you'll get a 100% tax deduction straight away.
2. When the whole or the majority (more than 50%) of an existing integral feature is replaced, that also goes into the special rate pool.
3. Minor replacements of integral features are unlikely to cause difficulty because they cost substantially less than replacing an entire integral feature. However, for substantial works, obtain and keep third party evidence of costs.

FIRST YEAR TAX CREDITS

What are these tax credits?

Currently, the effect of a 100% FYA is that the full cost of the plant and machinery incurred in a period may be deducted in computing the taxable profits of your business for that period. The new rules will expand the existing capital allowances regime to allow you to claim a cash repayment if your business is making a loss that year.

How do we qualify for these tax credits?

To qualify, the plant and machinery must not be second hand. It must also be of the type specified by Treasury Order and listed on the government's energy and water technology lists, normally by manufacturer and model (see <http://www.eca.gov.uk>). Sometimes, products must meet complicated performance specification requirements, for example, combined heat and power (CHP) outputs.

What is energy saving equipment?

Typical examples of energy saving equipment include: boilers, CHP, compressed air units, heating, ventilation and air conditioning zone controls and refrigeration. Examples of water conserving assets include: efficient showers, taps, toilets and washing machines, meters and monitoring equipment and rainwater harvesting equipment.

For expenditure on or after April 1 2008, it is possible for companies to surrender an element of their trading losses attributable to the energy saving or environmentally beneficial allowances (if any) in return for a cash payment from the government.

TAX TIP

Broadly, if your company has a loss, you can claim first year tax credits equal to 19% of that loss. This percentage applies regardless of the size of company, so there may be instances where it will better not to claim, but to carry the loss forward to be set against subsequent year's profits. This will save Corporation Tax at a higher rate of, say, 22% from April 1 2009.

The amount of the loss which may be surrendered is the lower of: **(1)** the amount of the first year allowance, i.e. the expenditure qualifying for 100% enhanced capital allowances; and **(2)** the actual loss.

Example

If qualifying FYA expenditure of £30,000 is deducted in computing a loss of £10,000, the tax credit available will be £1,900 (19% x £10,000). However, if an FYA of £30,000 is deducted in computing a loss of £60,000, the tax credit payable is £5,700 (19% of £30,000).

How much can we claim?

The rate of first year tax credit is set at 19% of the loss surrendered, subject to an upper limit. This upper limit will be the greater of: **(1)** the total of your company's PAYE and NI liabilities for the period; or **(2)** £250,000. Most companies have a PAYE and NI bill of less than £250,000. The good news is that the

repayment does not count as income of the company for tax purposes.

What if we then sell the asset?

If you sell the plant and machinery within a set period, the tax credit will be clawed back. This begins on the date the expenditure was incurred and ends four years after the end of the period for which the tax credit was paid. Then the tax credit must be repaid to HMRC and the relevant loss reinstated.

KEY POINTS

1. If your company makes a loss in a period in which it also invests in certain designated energy saving or environmentally beneficial plant and machinery, you could now get a payment from the Taxman.
2. Obviously, you can only take advantage of this new measure if your company has: (1) made a loss; and (2) invested in relevant equipment.
3. Be aware that if you do make a claim, the new rules will contain a mechanism for clawing back first year tax credits if the qualifying plant and machinery is sold within the clawback period.

THE NEW £1,000 WRITE-OFF

What is this new allowance?

Legislation has been introduced to allow you to claim a plant and machinery WDA of up to £1,000. However, the measure will not affect existing "single asset" pools, e.g. those for cars costing over £12,000, as they have special rules of their own. However, this will write off small historic pool balances immediately so that small claims of ever-decreasing amounts will no longer be needed.

Where the tax written down value (cost less capital allowances claimed to date) of a plant and machinery pool is no more than £1,000, you may now claim a WDA equal to the entire value of the pool.

Example

Mr Jones' 2006/7 tax computations show the carried forward total written down value of his main pool to be £2,000. He prepares his accounts to April 5 each year. In 2007/8 he incurs expenditure of £500 on office equipment and £750 on a heating system. In 2008/9 he incurs further expenditure of £1,100 on additions to the heating system. For the purposes of this example the impact of the AIA is ignored insofar as you can assume that it has been used in another business controlled by Mr Jones.

	MAIN POOL (£)	SPECIAL RATE POOL (£)	TOTAL CAs £
2007/8			
Brought forward	2,100		
Additions	1,275		
	3,375		
WDA at 25%	(844)		844
	2,531		
2008/9			
Additions		1,110	
WDA at 20% / 10%	(506)	(111)	617
	2,025	989	
2009/10			
WDA at 20%	(405)		405
Write-off of pool (< £1,000)		(989)	989
	1,620	Nil	
2010/11			
WDA at 20%	(324)		324
	1,296		
2011/12			
WDA at 20%	(259)		259
	1,037		
2012/13			
WDA at 20%	(207)		207
	830		
2013/14			
Write-off of pool (£1,000)	(830)		830

KEY POINTS

1. In future, if your business invests in plant and machinery, you will find that all of this expenditure will be fully relieved (100% in the first year) by the £50,000 AIA.
2. If, however, you are left with a small balance of unrelieved expenditure, this can also be written off immediately. Scrapping/writing off a few assets to bring a pool down to £1,000 in order to write the whole pool off might also be a good idea.
3. This provision is a triumph for common sense and will considerably reduce the administrative burden of capital allowances on many small businesses.

FIRE SAFETY EXPENDITURE

Who decides what we need to buy?

Historically, capital allowances have been available if you incurred fire safety expenditure "required" to comply with a notice issued under the **Fire Precautions Act 1971** or another document specifying the steps to take.

However, since the original tax rules were introduced, fire safety legislation has been reformed and now operates on a self-assessment basis (you're required to carry out your own fire risk assessment). Plus, the previous legislation didn't apply if expenditure was incurred voluntarily as a matter of good practice.

So what's the state of play now?

The capital allowances legislation that could encourage you to delay vital fire safety works until you were ordered to undertake them, has been repealed for expenditure on or after April 1 2008 (Corporation Tax) and April 6 2008 (income tax).

KEY POINT

Most of your fire safety expenditure should qualify for a revenue deduction. The change in the law does not affect relief for fire safety equipment that qualifies as plant and machinery in the normal way; for example, fire fighting and warning systems, such as sprinklers and alarms.

INDUSTRIAL BUILDINGS ALLOWANCES (IBAs)

What's changing?

One of the shock announcements of Budget 2007 was that industrial buildings allowances (IBAs) and agricultural business allowances (ABAs) would be abolished. The rationale given by the Treasury was that these were poorly targeted and their abolition would help fund the reduction in the main CT rate. However, if you are a smaller company losing IBAs, you do not benefit from the reduction in the main rate, but will see your CT bill increase by 22% of the IBAs lost. Individual investors will also not benefit from a reduction in the main CT rate and so could pay up to 40% tax on the income no longer offset by IBAs. OK, it is a phased abolition between now and 2011, however this is still a change which, essentially, has a retrospective effect.

Could we be affected?

Only if you are already claiming IBAs, ABAs and enterprise zone allowances (EZAs). On December 17 2007, it was announced that EZAs would also be withdrawn from April 2011 and that these (which primarily provide a 100% incentive allowance) will not be subject to the phasing-out rules applying to IBAs and ABAs.

The amount of allowance is to be stepped down (reducing your tax deduction) by 25% each financial/ tax year as follows:

FINANCIAL YEAR COMMENCING	TAX YEAR	ALLOWANCE %
April 1 2007	2007/8	100%
April 1 2008	2008/9	75%
April 1 2009	2009/10	50%
April 1 2010	2010/11	25%
April 1 2011	2011/12	0%

Example

If a property were acquired second-hand with, say, ten years of its 25-year IBA life left, so that the current claim is 10% p.a., this will reduce to 7.5%, 5%, 2.5% and then nil.

TAX TIP

Check your capital allowances computation this year to make sure the correct allowances percentages have been used. As a rule of thumb, the IBAs figure should only be 75% of the amount of last year's computation.

Where your accounting period overlaps a change in the available rate, you will have to use a hybrid rate for that year.

Example

A company with an accounting period of twelve months ending September 30 2008 will be able to claim a WDA for that year, on new expenditure of 3.5% ($186/366 \times 4\%$ plus $183/366 \times 3\%$). And so on, up to and including 2011.

The end result of all these changes will be that for your financial year beginning on or after April 2011, the remaining balance of IBA-related expenditure would simply be written off in your tax computations

without attracting tax relief. This will substantially increase future tax bills for affected businesses.

Example

Mike and his partner spent £3m on constructing a factory in 2007/8, expecting that the whole of the expenditure would qualify for IBAs over the next 25 years. At their marginal tax rate of 40% this would be worth £1.2m over time. Instead, they will begin claiming capital allowances at the expected 4% p.a., but will see this gradually reduce to 1% for 2010/11, before allowances cease altogether.

In April 2011 the residue of expenditure (that is the unrelieved part of the original cost) will be £2.6m, which will then be written off without tax relief. So in future years, the two owners will pay total additional tax of £1.04m (£2.6m x 40%) on their rental income.

TAX TIP

To obtain tax relief for expenditure on property in future, maximise your plant and machinery allowances claims. Review recent years' IBA claims and, where possible, switch expenditure from IBA treatment to plant and machinery. This is straightforward for open tax returns (i.e. those still within the statutory window to revise capital allowances claims). If you can't switch from IBAs to capital allowances now, do this when the property is sold by apportioning part of your selling price to represent plant and machinery.

Warning. There are some artificial arrangements doing the rounds which are designed to accelerate IBAs to ensure they are claimed in full before abolition. For example, using numerous group companies within different year-ends and making repeated intra-group sales is one such scheme. Unfortunately, these are generally ineffective because of a variety of tax and commercial reasons. Besides, anti-avoidance legislation was introduced to prevent them for most sales taking place after March 12 2008.

What happens if we sell an IBA asset?

For balancing adjustments, i.e. the sale or demolition etc. of an industrial building occurring on or after March 21 2007, your IBA claim for the purchase of a second-hand building will be based on your tax written down value for that building. So your sale of an existing industrial building will not, as previously, give rise to a balancing charge.

However, a transitional rule does apply. This means that the old rules and treatment apply to transactions on or after March 21 2007, in pursuance of a so-called "pre-commencement contract". This is a written contract in existence at March 21 2007, which was conditional.

Example

Old Ltd built a factory for £3m and claimed IBAs at 4% p.a. It sold the building to New Ltd on March 20 2007 for £4m. As it sold the building at a profit, it suffered clawback of all the allowances it had previously claimed. New Ltd could claim IBAs on £3m over the remaining five years of the building's 25-year life.

If the sale had taken place one day later, on March 21 2007, Old Ltd would not have suffered a clawback, and New Ltd's claim would have been limited to just £120,000 p.a., effectively inheriting the claim from Old Ltd.

What about enterprise zone allowances (EZAs)?

Although EZAs will no longer be available, balancing charges in respect of qualifying enterprise zone expenditure will be retained for a limited period. This is because where you dispose of a building within seven years of first use, in respect of which either an initial allowance or WDA(s) have been claimed, then the business is potentially liable to a balancing charge.

Where you have not claimed the full initial EZA, a WDA of 25% per annum is given on a straight-line basis. This will continue to be given in full until April 2011.

KEY POINT

Make sure the correct allowances percentages have been used to take account of the phased abolition.

SUMMARY OF CHANGES

Summary of capital allowances changes 2008/9 and effective dates.

DATE	EFFECTIVE BASIS	RULE CHANGE	LEGISLATION
April 1 2008 Corporation Tax (CT) April 6 2008 (income tax)	Capital expenditure incurred on or after	Abolition of 50% and 40% FYAs for small and medium sized enterprises	s.75 FA 2008
		100% annual investment allowance (time apportioned in transitional period)	s.74 and Sch 24 FA 2008
		10% WDA for integral features and thermal insulation of buildings	s.82 and Sch 26 FA 2008
		Repayable first year tax credit for plant and machinery qualifying for enhanced capital allowances	New Sch A1, CAA 2001 s.79 FA 2008
		Repeal of certain plant and machinery fire and safety rules	s.72 FA 2008

April 1 2008 (CT) April 6 2008 (income tax)	Chargeable periods ending on or after	Reduction in main rate of plant and machinery WDA to 20% (time apportioned hybrid rate of transitional period)	s.80 FA 2008
		Write off in full plant and machinery pools with a value of less than £1,000	New s.56A CAA 2001
		Reduction in IBA writing down allowance by one-quarter, e.g. to 3% (time apportioned hybrid rate in transitional period)	s.84 and 85 FA 2008

April 1 2009 (CT) April 6 2009 (income tax)	Chargeable periods ending on or after	Reduction in IBA writing down allowance by one-half, e.g. to 2% (time apportioned hybrid rate in transitional period)	s.84 and 85 FA 2008
April 1 2010 (CT) April 6 2010 (income tax)	Chargeable periods ending on or after	Reduction in IBA writing down allowance by one-half, e.g. to 1% (time apportioned hybrid rate in transitional period)	s.84 and 85 FA 2008
April 1 2011 (CT) April 6 2011 (income tax)	Chargeable periods ending on or after	Abolition of IBA writing down allowance by one-half, e.g. to 1% (time apportioned hybrid rate in transitional period)	s.84 and 85 FA 2008
		Abolition of enterprise zone IBAs	

CT = Corporation Tax

FYAs = first year allowances

WDA = writing down allowance

FA 2008 = Finance Act 2008

CAA 2001 = Capital Allowances Act 2001