CHAPTER 11

CAPITAL ALLOWANCES – FIRST YEAR ALLOWANCES AND THE ANNUAL INVESTMENT ALLOWANCE

In this chapter you will cover the rules for computing capital allowances on plant and machinery including:
- 100% first year allowances; and
- the annual investment allowance.

11.1 First Year Allowances

FYAs give businesses an enhanced rate of capital allowances on plant & machinery in the accounting period in which the expense is incurred. CAA 2001, s.39

Unlike writing down allowances, FYAs are not time apportioned in short or long accounting periods.

Special types of qualifying expenditure attract FYAs at 100% – this means that the whole of the expenditure is deducted from trading profits in the period (effectively allowing businesses to treat the expense as a revenue deduction).

Additions qualifying for the 100% first year allowances are entered into a 100% FYA pool. The FYA is then deducted at 100%.

The following types of expenditure attract FYAs at 100%:

a. designated energy saving plant and machinery which falls within a technology class specified in the "Energy Technology Criteria List" issued by the Department of Energy and Climate Change and meets the energy-saving criteria set out in that list (eg boiler systems, heating, ventilation and air conditioning equipment, high speed hand dryers, lighting, motors etc); CAA 2001, s.45A

b. designated environmentally beneficial plant and machinery which meets strict water saving or efficiency criteria (eg meters, monitoring equipment, flow controllers, leakage detection, efficient toilets and taps); CAA 2001, s.45H

c. plant and machinery installed at a gas refuelling station for use in connection with refuelling vehicles with natural gas, biogas or hydrogen fuel (eg storage tanks, compressors, pumps and any equipment for dispensing the gas); CAA 2001, s.45E

d. cars which are electrically propelled or have CO₂ emissions not exceeding 75g/km (95g/km where expenditure incurred before 1 April 2015); CAA 2001, s.45D

e. zero emissions goods vehicles. CAA 2001, s.45DA

The 100% first year allowance is only available if these assets are acquired unused and are not second hand, in other words if they are acquired new.
Capital expenditure on research and development incurred by a trader is also eligible for a 100% first year allowance. Qualifying capital expenditure includes plant, machinery and buildings (but not land) used for the purposes of carrying out research and development. \( \text{CAA 2001, s.438 & s.441} \)

11.2 The “Annual Investment Allowance” (AIA)

An “annual investment allowance” (AIA) is available for all businesses. The AIA is intended to “encourage greater levels of investment by reducing the costs of capital”. \( \text{CAA 2001, s.38A} \)

The AIA gives a 100% allowance for investment in plant and machinery (excluding cars) up to a specified amount. Since its introduction in 2008 there have been various changes to the AIA limit which applies for a 12 month accounting period. The AIA limit from 6 April 2014 is as follows: \( \text{CAA 2001, s.51A(5)} \)

<table>
<thead>
<tr>
<th>AIA limit for a 12 month accounting period</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
</tr>
<tr>
<td>6 April 2014 to 31 December 2015</td>
</tr>
<tr>
<td>(1 April 2014 for companies)</td>
</tr>
<tr>
<td>1 January 2016 onwards</td>
</tr>
</tbody>
</table>

As you can see from the above table, the annual AIA limit is £500,000 for the period 6 April 2014 (1 April 2014 for companies) to 31 December 2015 and then, from 1 January 2016, it has been reduced to £200,000 for the foreseeable future.

If the accounting period of the business is more or less than 12 months long, the AIA is proportionately reduced or increased. Thus for a business drawing up a 9-month set of accounts to 31 December 2015, the AIA will be £500,000 \times \frac{9}{12} = £375,000. \( \text{CAA 2001, s.51A(6)} \)

Expenditure in excess of the available AIA will be dealt with under the standard rules for capital allowances, qualifying for writing down allowances in the general pool or “special rate pool” (see later).

Any unused AIA will be lost – there is no provision for the unutilised portion of the allowance to be carried forward.

The business can decide which expenditure to allocate the AIA against, it does not have to be allocated to the first plant and machinery acquired in the accounting period.

The AIA rules are in addition to the 100% FYAs for environmentally beneficial technologies (energy or water saving plant), low emission cars etc. These are unaffected by the AIA.

**Illustration 1**

Craig is a self-employed car mechanic. He draws accounts to 31 December each year. The balance brought forward on his general pool at 1 January 2015 was £12,000.
During the year ended 31 December 2015 Craig incurred the following capital expenditure:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Cost (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 September 2015</td>
<td>Pressure washer</td>
<td>10,000</td>
</tr>
<tr>
<td>1 December 2015</td>
<td>Hydraulic car lift</td>
<td>60,000</td>
</tr>
</tbody>
</table>

Calculate the capital allowances available for year ended 31 December 2015.

**AIA**

<table>
<thead>
<tr>
<th></th>
<th>General Pool</th>
<th>Total CAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>@ 100%</td>
<td>£</td>
<td>£</td>
</tr>
</tbody>
</table>

**Y/e 31 December 2015:**

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax wdv b/fwd</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td>Additions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Pressure washer</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>– Hydraulic car lift</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>70,000</td>
<td>12,000</td>
</tr>
<tr>
<td>AIA @ 100%</td>
<td>(70,000)</td>
<td>70,000</td>
</tr>
<tr>
<td>WDA @ 18%</td>
<td>[2,160]</td>
<td>2,160</td>
</tr>
<tr>
<td>TWDV c/fwd at 31.12.15</td>
<td>9,840</td>
<td></td>
</tr>
<tr>
<td>CA claim for year</td>
<td></td>
<td>72,160</td>
</tr>
</tbody>
</table>

The new expenditure is covered in full by the AIA and therefore obtains relief at 100% in the year ended 31 December 2015. The balance of the AIA is wasted.

### 11.3 Time Apportioning the AIA – Accounting Period Straddles 1 January 2016

From 1 January 2016 the annual AIA limit has been reduced to £200,000. We therefore need to consider what happens when an accounting period straddles 1 January 2016.

The rules for calculating the maximum expenditure eligible for the AIA where the accounting period straddles 1 January 2016 are quite straightforward.

The maximum AIA for the accounting period is calculated by time apportioning the relevant AIA limit using the number of months in the accounting period before and after 1 January 2016.

There will be no further restriction when calculating the AIA available to set against expenditure incurred before 1 January 2016. However, the maximum expenditure incurred on or after 1 January 2016 which will be eligible for the AIA will be restricted to the time apportioned AIA for the part of the accounting period which falls after 1 January 2016. Of course, if this amount of AIA was utilised in respect of expenditure incurred prior to 1 January 2016, then no further relief is available.
Illustration 2

Pippa runs her own successful catering business, preparing accounts to 31 March each year. The balance brought forward on the general pool at 1 April 2015 was £40,500. During the year ended 31 March 2016 she incurred the following expenditure:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Cost (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 November 2015</td>
<td>Kitchen equipment</td>
<td>23,000</td>
</tr>
<tr>
<td>1 February 2016</td>
<td>3 delivery vans</td>
<td>58,000</td>
</tr>
</tbody>
</table>

Calculate the capital allowances available for the year ended 31 March 2016.

The maximum AIA for the year ended 31 March 2016 (calculated to the nearest month) is as follows:

\[
\text{Y/e 31 March 2016} \\
\begin{align*}
1 \text{ April 2015 – 31 December 2015} & \quad 500,000 \times 9/12 = 375,000 \\
1 \text{ January 2016 – 31 March 2016} & \quad 200,000 \times 3/12 = 50,000 \\
\end{align*}
\]

\[
1 \text{ April 2015} \quad 1 \text{ January 2016} \quad 31 \text{ March 2016}
\]

\[
\begin{align*}
\text{AIA} & = \£50,000 \\
& = (\£200,000 \times 3/12)
\end{align*}
\]

The £23,000 cost of the kitchen equipment will be eligible for the AIA since it cost less than the maximum AIA of £425,000 for the whole accounting period.

However, the maximum AIA in respect of expenditure incurred on or after 1 January 2016 is restricted to the AIA relating to the part of the accounting period after 1 January 2016 being £50,000 (£200,000 \times 3/12 as shown above). Therefore only £50,000 of the £58,000 cost of the new vans will be covered by the AIA.

Additions pre 1 Jan 2016:
- Kitchen equipment: 23,000

Additions on/after 1 Jan 2016:
- New vans: 50,000, 8,000
- AIA @ 100%: 73,000, 48,500
- WDA @ 18%: (8,730), 8,730
- C/fwd at 31.3.16: 39,770
- CA claim for year: 81,730
Of course, if the new vans had been bought before 1 January 2016 the whole £58,000 cost would have been covered by the AIA and would have obtained relief at 100%.

11.4 AIA Restrictions

The AIA is available to all businesses (including ordinary property businesses and large companies) although only one AIA is available to each business each year.

Sole trader businesses and partnerships of which all the members are individuals will each receive an AIA. Therefore where an individual is involved in more than one business (for example, he may be a partner in a firm and run a sole trader business in his own right at the same time) both businesses will receive an AIA.  CAA 2001, s.38A(3b)

However where an individual is a sole trader with more than one trade, he is only entitled to one AIA between the trades. He may then allocate the AIA across the trades as he sees fit.  CAA 2001, s.51H

Partnerships which include a company as a partner are not eligible for the AIA.

A “group” of companies is treated as one business for the AIA. This means that the group will receive only one AIA between them, as opposed to one for each group company. A “group” in this context is a parent company and its 51% subsidiaries. The group can allocate the AIA between them as they wish.  CAA 2001, s.51C

Similarly, companies under “common control” are also treated as one business for the AIA. Again the companies can choose how they allocate the AIA.  CAA 2001, s.51E

“Common control” means that:

a. the companies are controlled by the same person; and

b. the companies are “related” to one another.

Companies are “related” to one another if either:  CAA 2001, s.51G

a. the businesses are carried on from the same premises; or

b. more than 50% of the turnover of the companies are derived from the same economic activities.

This essentially means that if an individual owns two companies, A Ltd and B Ltd, both A Ltd and B Ltd will each receive their own AIA unless:

a. A Ltd and B Ltd trade from the same premises, or

b. A Ltd and B Ltd carry on very similar trading activities,

in which case one AIA must be shared between them.

This prevents individuals exploiting the rules to obtain more capital allowances by “spreading” the same business between different companies.
No annual investment allowance or first year allowance is available if the plant and machinery is acquired from a ‘connected person’. \textit{CAA 2001, s.214; CAA 2001, s.217}

For these purposes a ‘connected person’ is defined as:

- The individual’s spouse/civil partner,
- A ‘relative’ of the individual or his spouse/civil partner,
- The spouse/civil partner of the relative of the individual
- The spouse/civil partner of the relative of the individual’s spouse/civil partner

‘Relative’ means brothers, sisters, ancestors (ie parents, grandparents etc) or lineal descendants (ie children, grandchildren etc).

The following diagram illustrates who an individual’s connected persons are:

![Diagram]

The term ‘connected person’ also includes the following:

- The trustee of a settlement is connected with any individual who is a settlor in relation to the settlement
- A partner in a partnership is connected with both the other partners and the spouse/civil partner of the other partners
- A company is connected with an individual if they alone or together with someone connected to them control the company
- A company is connected with another company if one controls the other or they are both under common control. \textit{CAA 2001, s.575}
EXAMPLES

Example 1

Ted runs his own business. In the year to 31 January 2016 the following information is given:

TWDV b/f:
- General pool £60,000

Additions:
- New machinery (1.6.15) £275,000
- Second-hand delivery van (1.12.15) £6,000
- New computers & printers (1.1.16) £30,000

Disposals:
- Office furniture (1.10.15) (£1,000)

Calculate the capital allowances due for the year.
ANSWERS

Answer 1

<table>
<thead>
<tr>
<th></th>
<th>AIA @ 100%</th>
<th>General Pool</th>
<th>Total CAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y/e 31 January 2016:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax wdv b/f</td>
<td></td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Additions pre 1 January 2016 (W1):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Machinery</td>
<td>275,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Delivery van</td>
<td>6,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions on/after 1 January 2016:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Computers and printers</td>
<td>16,667</td>
<td>13,333</td>
<td></td>
</tr>
<tr>
<td>Disposal:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Furniture sold</td>
<td>297,667</td>
<td>72,333</td>
<td>297,667</td>
</tr>
<tr>
<td>AIA @ 100%</td>
<td>(297,667)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDA @ 18%</td>
<td>(13,020)</td>
<td>13,020</td>
<td></td>
</tr>
<tr>
<td>TWDV c/f</td>
<td>= 59,313</td>
<td>310,687</td>
<td></td>
</tr>
<tr>
<td>Total CA claim</td>
<td>310,687</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Workings:

W1: Maximum AIA available

Y/e 31 January 2016

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 February 2015 - 31 December 2015 (500,000 x 11/12)</td>
<td>458,333</td>
</tr>
<tr>
<td>1 January 2016 – 31 January 2016 (200,000 x 1/12)</td>
<td>16,667</td>
</tr>
</tbody>
</table>

475,000

The maximum amount of AIA that is available to set against expenditure incurred on or after 1 January 2016 is restricted to £16,667 (£200,000 x 1/12).