TAX FACULTY

The new capital allowances regime: illustrations of the computations

Finance Acts 2007 and 2008 introduced new rules for capital allowances, applying in most cases from April 2008.

Tax Faculty members will have received *TAXline Tax Practice* No 21, *Capital Allowances: the new rules*, in September 2008, which explains the rules in detail.

In these days of computerisation and programmes which do many of the calculations automatically, it is easy to forget how some of the legislation translates into practice. As we have received some enquiries from members about the mechanics of the new computations, we have prepared some illustrations which may be helpful.

Our illustrations cover two situations:

1. Capital allowances in the opening years of an unincorporated business

2. The special rate pool and long-life assets.

Notes:

- Capital allowances for a sole trader or a partnership are calculated for each period of account, not for each tax year. Capital allowances for a company are calculated for each accounting period.

- Rules which come into effect in April 2008 apply from 1 April 2008 for corporation tax and from 6 April 2008 for income tax.

- For our illustrations, all calculations are to the nearest month for simplicity although, in practice, days should be used.

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Illustration 1: Pre-trading expenditure and opening years

Lynne started trading on 1 May 2008 and decided to make up accounts to 31 May.

Her first period of account ran from 1 May 2008 to 31 May 2009. Her taxable trading income before capital allowances was £157,265.

Lynne bought plant and machinery as follows:

		£
8 April 2008	Machinery (bought for the business)	6,730
1 May 2008	BMW car	25,900
1 October 2008	Equipment	68,200

The car is not a low emission car. It is used 60% privately by Lynne.

Lynne's business is a small business (VAT has been ignored).

Capital allowances calculation

The capital allowances in the 13-month period of account to 31 May 2008 are as follows:

	AIA £	*Main pool* £	*BMW* £	*Allowances* £
Period of account 1.5.08 to 31.5.09				
Additions (no AIA)				
1.5.08 Car			25,900	
WDA @ 20% x 13/12 (restricted to £3,000 x 13/12)			(3,250) × 40%	1,300
Additions (AIA)				
8.4.08 Machinery	6,730			
1.10.08 Equipment	68,200			
	74,930			
Less: AIA* (long period)	(54,167)			54,167
WDA @ 20% x 13/12		20,763		
		(4,499)		4,499
TWDV c/f		16,264	22,650	
Allowances				59,966

*The maximum AIA for the period 1.5.08 to 31.5.09 is 13/12 x £50,000 = £54,167.

Note: Had the machinery bought prior to trade beginning first been used for non-trading purposes, the AIA would not have been available; new s 38B, CAA 2001.

Had the expensive car cost between £12,000 and £14,999, its WDA @ 20% x 13/12 would have been less than the maximum permitted of £3,000 x 13/12 and would not therefore have been restricted.

(Illustration 1 – continued)

Taxable trading income p/e 31 May 2009

	£
Taxable trading income before capital allowances	157,265
Less: capital allowances	(59,966)
Taxable trading income	97,299

Taxable trading income for opening years

The taxable trading income in the opening years, showing the amount of any overlap profits, is as follows:

First tax year (2008/09)

Actual basis

Basis period 1 May 2008 to 5 April 2009

11/13 × £97,299 £82,330

Second tax year (2009/10)

Period of account longer than 12 months, ending in second tax year

Basis period 1 June 2008 to 31 May 2009

ie 12 months to the end of the period of account in the second tax year:

12/13 × £97,299 £89,814

Overlap profits

1 June 2008 to 5 April 2009

10/13 × £97,299 £74,845

Illustration 2: Special rate pool and long life assets

Jacob is a sole trader making up accounts to 30 November each year. The tax written down values of his plant and machinery at 1 December 2007 were:

	£
Main pool	65,300
Long life asset pool	112,000

During the year ended 30 November 2008 Jacob made the following acquisitions:

		£
10.4.08	Toyota Aygo with CO_2 emissions of 108g/km	6,950
1.7.08	Machinery	29,600
1.8.08	Thermal insulation	35,000
20.9.08	Lift installation	42,000

Jacob sold a machine on 12 July 2008 for £11,300.

Section 80(10), FA 2008 requires calculations of the hybrid rate to be to two decimal places. Where this would be a figure with more than 2 decimal places, it is to be rounded up to the nearest second decimal place. For the purposes of this illustration, the hybrid rate is calculated to the nearest month.

The maximum capital allowances that Jacob can claim for the year ended 30 November 2008 are calculated as shown on the following page.

Note: For long-life asset expenditure already in a pool existing before the rate change, a 'hybrid' rate of WDA applies to the TWDV brought forward on the basis of time-apportionment (similar to the main rate of WDA). However, for expenditure incurred on or after 1 and 6 April 2008 (for corporation and income tax respectively) the full 10% rate will apply for the chargeable period in which the expenditure is incurred, even if that period is a transitional period.

With effect from 2008/09, low emission cars for the purposes of capital allowances are defined as having CO_2 emissions of ≤110g/km. However, for the purposes of the new lower rate of taxable benefit for employees, they are defined as having CO_2 emissions of ≤120g/km.

On 1 December 2008 the balance of £102,290 on the LLA pool will be transferred into the special rate pool.

(Illustration 2 – continued)

Capital allowances calculation

		FYA	*AIA*	*Main pool*	*LLAs*	*Special rate pool*	*Allow-ances*
		£	£	£	£	£	£
Period of account 1.12.07 to 30.11.08							
TWDV b/f				65,300	112,000		
Additions (FYA)							
10.4.08	Low emission car (≤110g/km)	6,950					
	FYA @ 100%	(6,950)					6,950
Additions (AIA)							
1.8.08	Thermal insulation		35,000				
20.9.08	Lift installation		42,000				
			77,000				
AIA (50,000 × 8/12) (1.4.08 – 30.11.08)			(33,333)				33,333
			43,667			43,667	
Other additions							
1.7.08	Machinery			29,600			
Disposals				(11,300)			
				83,600	112,000	43,667	
WDA @ hybrid rate 21.67% (4/12 × 25%) + (8/12 × 20%)				(18,116)			18,116
LLAs @ hybrid rate 8.67% (4/12 × 6%) + (8/12 × 10%)					(9,710)		9,710
Special rate pool @ 10%						(4,367)	4,367
TWDV c/f				65,484	102,290	39,300	
Allowances							72,476