

## **Capital allowances: machinery and plant**

Major changes have taken place in relation to the capital allowances regime for machinery and plant. Some of the changes are in the taxpayer's favour, but others will reduce reliefs available.

In the past, machinery and plant had qualified for 25% annual writing down allowances each year on the balance of expenditure at the beginning of the year in the equipment pool. Under the Finance Act 2008, the relief in future years is set at 20% per annum. However, this is counterbalanced by the introduction of a new annual investment allowance which applies to the first £50,000 of a business's expenditure on plant and equipment. This allowance available in each year will qualify for 100% relief against profits, so effectively a general first year allowance is introduced for all plant and equipment up to a value of £50,000 in each year. This will remove one of the issues which has traditionally been troublesome in relation to Inland Revenue enquiries into business accounts, in that grey areas between what qualifies as revenue expenditure allowable against trading profits and what qualifies for capital allowances has been a fruitful area for dispute and thus for HMRC to collect tax interest and penalties (e.g. in respect of certain software, music CDs, videos). However, it will still be important to identify what qualifies for 100% relief under the annual investment allowance, and not as revenue expenditure. Any items within the category of capital expenditure qualifying for machinery and plant allowances are subject to a balancing charge or allowance on eventual disposal and it will remain important to be able to identify such cases in the future.

The annual investment allowance does not apply to business cars and there is also a new rule which denies relief where transactions are entered into for the main purpose of obtaining the investment allowance where it would not otherwise have been due.

Apart from the phasing out of agricultural buildings allowances and industrial buildings allowances, another major change relates to machinery and plant which is an integral feature of a building. In the past, this has been the one area in which it was possible to obtain some tax relief for the cost of office buildings. Certain equipment forming an integral feature of the building could be identified as qualifying for machinery and plant allowances, examples being hot water systems, toilet facilities, lifts and heating arrangements.

The Finance Act 2008 now takes such items out of the machinery and plant pool and puts them into a new special rate pool which will attract writing down allowances of only 10% per annum. There is a list of items falling within this provision and this is as follows:

- An electrical system (including a lighting system)
- A cold water system
- A space or water heating system
- A powered system of ventilation

- Air cooling or air purification including any floor or ceiling comprised in such a system
- A lift, escalator or moving walkway
- External solar shading

There are both good things and bad things about this list. The welcome news is that all electrical systems now qualify for some relief; previously, only electrical circuits serving specialised equipment qualified for capital allowances. Also cold water systems never previously qualified for any relief. However, the less welcome news is that false ceilings or floors which formed part of a powered ventilation system have in the past been accepted as machinery and plant, as also have lifts and the like, but these are now removed into the special pool so that only 10% allowances will be available.

The bad news does not quite end there. Where expenditure on an integral feature is incurred which exceeds 50% of the cost of replacing the feature, that expenditure, even if it is otherwise to be treated as revenue expenditure deductible against profits, is now removed from the profit and loss account and must go into the new special rate pool, qualifying for only 10% allowances per annum. Worse still, this rule applies to expenditure on all integral features incurred after 5 April 2008 for non corporate businesses and after 31 March 2008 for companies. So even if the new expenditure exceeding 50% of replacement cost is on an old integral feature which never qualified for any tax deduction or allowance, that new expenditure is still caught by the new rules. Also, it may well be difficult in many cases to decide what the replacement cost of the equipment is. Equipment of its type may no longer be available, or in the case of electrical systems it may not be clear how much of the complete electrical system has to be included, for the purposes of the 50% test, when some work is being performed on part of the circuit. In the future, it will now be necessary to obtain information about the replacement cost of integral features in buildings whenever major works are to be carried out on them. It will be as well to have this information on file, as any enquiry into a return will inevitably arise some considerable time thereafter when the relevant information may be more difficult to obtain.

Fortunately these complexities for integral features will not trouble businesses whose total annual expenditure on plant and equipment, including integral features, does not exceed £50,000 per annum. This is because the annual investment allowance of £50,000 on which 100 % relief is available applies to equally to expenditure on integral features, as it does to expenditure on ordinary plant and machinery.

Continuing interest by the Inland Revenue in the topic of capital allowances for machinery and plant was more than evident earlier this year when the decision of the Special Commissioners in the case of *J D Wetherspoon* was published. A large number of items in the Wetherspoon chain of pubs/restaurants was under dispute and some surprising conclusions were reached in the decision, in particular no relief was to be given for the wood panelling installed around the walls of the customer areas. Also failing to attract relief were kitchen tiles. However, the company was successful in

relation to the cost of toilet cubicles (it was strange that HMRC disputed these items) and also the cost of special drainage systems.

The clear message is that the whole topic of capital allowances for machinery and plant remains very much a live issue and one in which taxpayers need to take particular care with their claims each year.

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