ISUZU Truck Finance

How the Inland Revenue is helping UK businesses invest in capital equipment

Why delaying capital expenditure might be a mistake?

As we move towards the end of another fiscal year (and for many businesses, individual financial year ends), it is well worth looking again at the tax incentives currently on offer to encourage businesses to invest in capital equipment.

The Annual Investment Allowance (AIA) of £500,000 has been set for the calendar year 2015 and is set to reduce to £200,000 from January 2016. This means that the cost of purchasing qualifying business assets (up to £500,000) can be fully offset against tax in the current calendar year. For businesses expecting to make an annual profit in excess of £200,000, this is a powerful reason to bring forward any planned capital expenditure to take advantage of the very generous 2015 allowances.

It is well worth adding that any such businesses who are looking to invest can take full advantage of hire purchase agreements, thereby getting the benefit of the generous tax allowances currently on offer whilst spreading the cost of purchase over a period that suits budgetary and cash flow requirements.

How the Inland Revenue is helping UK businesses invest in capital equipment

Governments of all political colours have always allowed businesses to reduce their tax bills when they invest in capital equipment. But how does this work?

So long as businesses make a profit they will pay either income tax (if they are unincorporated businesses), or corporation tax if they trade as limited companies. The amount of tax paid will be based on their marginal tax rate and calculated as a percentage of pre-tax profits.

The basis on which the acquisition of capital equipment can reduce the amount of tax paid is that the Inland Revenue allows the costs associated with such expenditure to be deducted in computing taxable profits, therefore reducing the profits on which tax is paid. Certain types of asset might be subject to individual and changing tax treatment (e.g. vehicles).

There are three methods of acquiring capital equipment:

1 Credit agreements (Hire Purchase)	**2 Hire agreements** (Rental)	**3 Cash purchase**

1 Credit agreements (Hire Purchase)

Businesses often use debt finance to purchase capital equipment. This can be way of a finance agreement where ownership is transferred to the hirer upon expiry (credit agreements). Such agreements are often referred to as lease purchase or hire purchase.

In both cases the business is able to claim tax allowances (writing-down allowance and/or AIA) in the same way that would be the case if they had purchased the equipment concerned outright. Further, any interest charges payable in respect of a finance agreement or bank loan can also be charged as an expense to further reduce tax liability.

The tax treatment of purchased assets is described below under 'cash purchases'.

2 Hire agreements (Rental)

Hire agreements which include contract hire, leasing and rental agreements involve a business simply hiring equipment for a period of time. Once the agreement comes to an end, the equipment is returned. In such cases the Inland Revenue allows the hirer to class all rental payments as a business expense which has the effect of reducing pre-tax profits and therefore the amount of tax paid.

Such tax allowances are available on an annual basis for the length of the leasing agreement. Specific rules apply to classify a lease as an operating lease, also known as 'off balance sheet' funding.

3 Cash purchase

Where equipment is purchased rather than simply rented, the Inland Revenue recognises that the business making the investment has to bear the cost of the assets, and that these reduce in value through depreciation. As such, a charge for depreciation can be included as a deduction when computing taxable profits and the amount of tax paid.

The tax allowance available to businesses that purchase assets is known as writing-down allowance (WDA), and this currently stands at 18% of any unclaimed allowance per annum. Therefore for the year in which the asset was purchased, 18% of the purchase price can be deducted in computing taxable profits, and the tax bill will be reduced accordingly.

In the second year, allowances are calculated on the basis of the original purchase price minus the 18% previously claimed - this becomes the new figure on which an 18% allowance will be applied as a deduction in the second year. This is repeated for as long as the business retains the asset. The percentage allowance is often subject to change within government budget statements, depending on the degree to which a chancellor wishes to stimulate business investment.

A relatively new development has been the introduction of AIA. This offers accelerated tax benefits up to a specified level of annual investment. Once the allowance has been used, the business concerned would qualify for a writing-down allowance as described above for any further expenditure.

For each of the years 2014 and 2015, the AIA was set at £500,000. This entitles a business to acquire up to £500,000 of qualifying assets and charge the full cost of the investment as an operating expense in the year in which the equipment concerned was purchased. When applied, this can have the effect of significantly reducing the amount of tax paid in the short term. The annual investment allowance is set to be reduced to £200,000 from January 2016.

All concerned need to be aware that AIA and WDA can only be claimed from the time the asset is delivered and operational, therefore for any organisations wishing to take advantage of the relatively high level of AIA currently available must allow enough time for their orders to be completed by the end of the year.

To discuss your finance options please contact Andy Cole on 07966114211.

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