

CAPITAL ALLOWANCES AND BALANCING CHARGES IN A RENTAL BUSINESS

This Help Sheet gives you information to help you fill in the Land and Property Pages in your Tax Return. The box numbers mentioned below refer to those Pages.

In working out your rental business profits you must not deduct the cost of buying, altering or improving fixed assets, or depreciation or any losses that arise when you sell them. Instead, you may be able to claim tax allowances called capital allowances. These are deducted in working out your profits in box 5.36. An adjustment, known as a balancing charge, may arise when you sell, give away or stop using an item in your business. Balancing charges are added to your profits in box 5.33. These notes explain how you can work out these capital allowances and balancing charges.

WHAT CAN CAPITAL ALLOWANCES BE CLAIMED ON?

You can claim capital allowances for the cost of plant and machinery such as vehicles, tools, ladders, computers and business furniture that belongs to you (see 'Plant and machinery' below), and agricultural buildings, industrial buildings and certain other buildings.

First year allowances are available for most expenditure on plant and machinery apart from expenditure on motor cars or assets which you lease out.

The percentage to be used depends on when the item was bought, and where it is to be used, as follows:

| | Rate of first year allowance |
|---|------------------------------|
| Most items acquired by small and medium sized businesses for use primarily in Northern Ireland (see Note 1) | 100% |
| Expenditure on energy-saving plant or machinery | 100% |
| Expenditure incurred by energy services providers | 100% |
| Items acquired for use elsewhere | 40% |

If the asset is used only partly for business the first year allowance is reduced accordingly.

Note 1: the 100% first year allowance is not available for goods vehicles used in a haulage business and unauthorised expenditure on items for use primarily in agriculture and fishing businesses.

Where a first year allowance is claimed the balance of the expenditure after deducting the first year allowance is added to the pool for the following year.

If you buy on hire purchase, you can claim capital allowances on the original cost of the item; the interest or other charges count as business expenses and should be entered in box 5.26.

You cannot claim for anything bought solely for private use, or for plant and machinery like furniture let for use in a dwelling house.

HOW TO MAKE A CLAIM

Enter in boxes 5.36 and 5.33 the amounts you wish to claim or return. These figures should be the amount worked out from the rules set out in these notes unless you choose to claim a lower amount. If you are in doubt, ask your Inland Revenue office or tax adviser for help.

PLANT AND MACHINERY

You can claim plant and machinery allowances for the cost of cars, machines, scaffolding, ladders, tools, equipment, furniture, garden equipment and similar items that you use in your business. The allowances are known as writing down allowances. These are worked out at 25% of the cost of the item or 'pool' of items for each year (unless you are claiming first year allowance - see aside) Example 1 shows how writing down allowance and first year allowances work.

Example 1

You complete your Tax Return for the year to 5 April 2002. You spend £200 on ladders in May 2001, £600 on lawnmowers in June 2001 and £1,200 on a fax machine in August 2001. Your capital allowance computation for 2001-02 is:

| | |
|---|-------------|
| Cost of fax machine | £1,200 |
| First year allowance @ 40% | <u>£480</u> |
| Value carried forward | £720 |
| Cost of ladders and mowers | £800 |
| (You decide not to claim first year allowance) | |
| Writing down allowance @ 25% | <u>£200</u> |
| Value carried forward | £600 |

The pool to carry forward to 2002-03 is £1,320 (£720 + £600).

The writing down allowance you can claim for 2002-03 is:

| | |
|-------------------------------|-------------|
| Value of pool brought forward | £1,320 |
| Writing down allowance @ 25% | <u>£330</u> |
| Value of pool carried forward | £990 |

The 25% rate applies if your business operates throughout the year, even if you only bought the item part way through the year.

If your business starts during the year, the 25% is reduced in proportion. So if you start six months into the tax year, you can only claim 12.5% ($25\% \times \frac{1}{2}$).

Most plant and machinery you buy for your business can be lumped together in a single 'pool' of expenditure with just a single calculation no matter how many items are included. This is known as 'pooling'. (The types of plant and machinery that cannot be pooled are explained later in these notes).

If you buy something in the period covered by your accounts, the cost is added to the pool. You can also bring into the pool the value of any items that you used privately before using them in your business. If you sell something, the sale proceeds (or the value, if you gave it away or started to use it for non-business purposes) are deducted from the pool. Once these adjustments have been made, your writing down allowance for those accounts is calculated.

Example 2

Suppose that after the first two years in Example 1 you spend £2,000 and £500 on two new fax machines and you sell your lawnmower for £150. The pool brought forward at 6 April 2003 is £990. The writing down allowance you can claim for 2003-04 is:

| | |
|--------------------------------|--------|
| Value of pool brought forward | £990 |
| Additions | £2,500 |
| Total | £3,490 |
| Disposals | £150 |
| Pool for 2003-04 | £3,340 |
| Writing down allowance @ 25% | £835 |
| Value of pool to carry forward | £2,505 |

If the sale price is more than the value of the pool, the difference is a balancing charge. This should be entered in box 5.33.

If your business ceases, you should deduct from the value of the pool the sale prices for any items you sell, or their values if you keep them. If these are more than the value of the pool, the difference is a balancing charge. If there is any value remaining in the pool, do not work out a writing down allowance, but instead claim the value remaining as an additional allowance called a balancing allowance.

The precise way the allowances are worked out depends on the type of item and whether you use it privately as well as for business. The following rules will help you work out how much to claim under each of the headings. However, if

- you do not want to claim the full amount of allowances, **or**
 - someone else pays part of the cost (for example, by giving you a grant), **or**
 - you had purchases from, or sales to, members of your family or other connected persons,
- ask your Inland Revenue office or tax adviser for advice.

MOTOR CARS

When you use a car for your rental business, capital allowances may be claimed.

For expensive cars, which cost more than £12,000, the 25% writing down allowance is restricted to £3,000 a year for each car. A separate calculation must be made for each such car - they are not 'pooled'.

When you sell the car, the difference between the sale price and the value brought forward is allowed as a balancing allowance (added to other capital allowances for the year) or, if a profit, is taxable as a balancing charge, subject, in either case, to any necessary restriction for private use.

Example 3

Your accounts are drawn up for the year to 5 April 2002. You spend £15,000 in that year on a car that is used in your rental business. The business usage is agreed at 30%:

| | |
|---|---------|
| Cost of car | £15,000 |
| Writing down allowance @ 25% (restricted) | £3,000 |
| Value to carry forward | £12,000 |

The writing down allowance you can claim is £3,000 x 30% = £900.

There is a separate pool which contains all motor cars costing £12,000 or less. The writing down allowance is 25% of the balance in the pool.

Where such a car is used partly for private purposes it must not be 'pooled'. Instead, a separate calculation must be made for each car.

PLANT AND MACHINERY USED ONLY PARTLY FOR BUSINESS

These items should not be included in any pool. Instead the allowances on each item should be worked out separately. The writing down allowance, and any balancing allowance or charge when the item is sold, should be reduced so that only the business use proportion is taken into account.

Example 4

You buy a computer for £8,000 in January 2002 and sell it for £4,000 in March 2003. You use it 50% for rental business. The calculation is:

| | | |
|---------|----------------------------|--------|
| 2001-02 | Cost of computer | £8,000 |
| | First year allowance @ 40% | £3,200 |
| | Value to carry forward | £4,800 |

The first year allowance which can be claimed is £1,600 (£3,200 x 50% business use).

| | | |
|---------|-----------------------|--------|
| 2002-03 | Value brought forward | £4,800 |
| | Sale price | £4,000 |
| | Difference | £800 |

The balancing allowance which can be claimed is £400 (£800 x 50% business use).

ASSETS LEASED OUT

You can claim capital allowances for assets you own and lease out to other users. Capital allowances on these assets should be claimed in the same way as for assets you use personally in your rental business. However, if the asset is used by a person who is not resident in the UK, you will need to discuss with your Inland Revenue office or tax adviser which allowances are due. Unless you are conducting a leasing trade, assets leased out are not pooled. A separate capital allowances calculation should be made for each asset leased out.

BUILDINGS

You can claim capital allowances for the cost of constructing agricultural buildings, industrial buildings, industrial and commercial buildings in enterprise zones and certain types of hotel, and the cost of the renovation or conversion of vacant or underused space above shops and other commercial premises to provide flats for rent.

If you want to claim agricultural buildings allowance, ask the Orderline for *Help Sheet IR224: Farmers and market gardeners*. This contains information about the allowance as well as other special rules that apply to farmers and market gardeners.

You can claim industrial buildings allowance if you buy or construct a building used for the purposes of a qualifying trade. Manufacturing is a qualifying trade, as are processing trades and there are certain others. You cannot claim industrial buildings allowance on buildings such as houses, showrooms, offices and shops even if they are used for the purposes of a qualifying trade, or for the land on which the building stands. If you think you may be able to make a claim, ask your Inland Revenue office or tax adviser.

You can claim capital allowances at a special rate on industrial and commercial buildings in enterprise zones. You can also claim capital allowances for the cost of a qualifying hotel. For information about allowances on these types of building, ask your Inland Revenue office or tax adviser.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.