£1m Annual Investment Allowance extended to 1st January 2022

New announcement from the Treasury

Afilia

Capital Allowances

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A last minute reprieve

On November 12th, Jesse Norman, the Financial Secretary to the Treasury, announced that the Annual Investment Allowance (AIA) which had been due to reduce to £200,000 on the 1st January 2021, will now continue at its current level of £1,000,000 until 1st January 2022. He commented; "It is vital that we support business through the difficult months ahead. Extending the Annual Investment Allowance's £1million cap will give businesses the confidence they need to invest into next year, helping them to grow whilst benefitting the wider economy too."

This is much to be welcomed given the perfect storm of challenges to business that have been created by the pandemic and Brexit. It is only unfortunate that the announcement comes late in the year and just weeks before the AIA was due to reduce. Investment decisions are seldom taken without lengthy consideration and preparation and it could have been more effective if the announcement had been made sooner.

How the AIA works

The AIA is often mistakenly assumed by many taxpayers to be a classification of tax relief which exists in its own right. This is not the case - it is actually an acceleration of a new claim for plant & machinery relief. In other words, if the AIA is set at £1m and a taxpayer incurs qualifying expenditure - then up to £1m of the claim is added to the first year's writing-down allowances. For the majority of businesses the £1m AIA is sufficient to cover all of their plant & machinery claims in a year.

Once the AIA is deducted from a new claim, then the remaining balance of allowances is taken at the usual Main and Special Rate Pool writing-down rates in the following years until the relief is used up.

The value of the AIA has see-sawed over time but £1m is the highest rate in its history and is a level which can make a real impact on project viability.

The value in property projects

Many property owners understandably have difficulty in interpreting the value of the AIA in relation to their own business activity. It may help to set out a couple of simple illustrations.

Office refurbishment illustration	
Construction budget	£3m
Plant & Machinery content	£1.5m
Year 1 tax calculation:	
AIA	£1m
Writing down allowances	£90,000
Repairs say	£150,000
Total year 1 claim	£1,240,000
Tax saved at 19% rate	£235,600
Percentage of budget saved	7.8%

In the first above, we show an office refurbishment project costing £3m - of which £1.5m qualifies as plant & machinery and with an additional £150,000 as repairs. The first year tax relief claim shows the AIA, then the writing-down allowances of £90,000 on the balance of the plant & machinery, and finally the repairs. In total £1.24m in tax relief translating into £235,600 of tax savings, or 7.8% of the budget - with the remainder of the plant & machinery still to be claimed.

The second example, below, shows a less costly GP surgery refurbishment at £500,000. Here some £200,000 is plant & machinery and then repairs added of £50,000. The AIA absorbs all of the plant & machinery and so with the repairs the first year claim is £250,000 - and at the 40% tax rate this equates to £100,000 for the GP partners - or 20% of budget.

Why is this important?

In both examples the value of the first year savings can make a valuable contribution to assessments of project viability - but the problem which continues to exist across the construction industry is, firstly, that clients may have no more than a sketchy idea of the value of Capital Allowances in relation to property. Their past experience may be only related to purchases of production equipment. Secondly, most construction professionals have little contact with Capital Allowances - because for the most part their clients do not ask for any guidance. Traditionally the subject is left to be an accountancy issue - dealt with as post-project diligence. Hence it becomes a Catch-22 - nobody asks about it as they don't know about it - so nobody else bothers to learn about it because nobody asks about it.

Surgery refurbishment illustration	
Construction budget	£500,000
Plant & Machinery content	£200,000
Year 1 tax calculation:	
AIA	£200,000
Writing down allowances	Nil
Repairs say	£50,000
Total year 1 claim	£250,000
Tax saved at 40% rate	£100,000
Percentage of budget saved	20%

Value engineering

In any construction project, as the preparatory phase ends, it is now not unusual to undertake a value-engineering exercise to ensure the lowest-cost options are specified. In many instances, however, this can lead to cheaper less aesthetically-pleasing finishes. Not a game changer on the basis of one item - but applied across the board it can have a significant impact on the overall look-and-feel of the finished building.

This can have a number of outcomes. Firstly, if the property is going to be let then it may reduce its appeal and slow the marketing. Secondly, it may reduce the building's attractiveness as a workplace with a knock-on impact on staff productivity and retention. Lastly - asset longevity - poorer finishes will mean the building starting to look tired sooner than it might have done - and with a possible downstream impact on re-lettability and investment value.

Meeting client expectations

If there is an awareness by project decision-makers of the scope and scale of tax relief, it may have a beneficial impact on the view of viability, with a resultant more considered approach to value engineering. It is not uncommon that the client's initial wish-list has already have been scaled back to try and stay within budgetary constraints.

Where a preliminary review of the Capital Allowances and any other available reliefs is undertaken as the costings evolve, then in fact this might show that the budget can go further - and discarded choices reinstated onto the wish list.

Also, the benefit of a large first year tax-saving factored into the cash flow, can reduce budgetary pressures that otherwise lead to unhelpful tensions between client and contractor.

The post-ECA world

The Enhanced Capital Allowances scheme ended on April 1st this year leaving the UK without a fiscal incentive to encourage improved energy performance in commercial buildings. ECAs were never seen as particularly user-friendly, but combined with very little publicity on their availability meant the take-up was always limited.

Nevertheless identifying more efficient choices of equipment is still possible using the Energy Technology List (published by the Carbon Trust) and offers obvious benefits of achieving lower running costs. Strategically it can help future-proof a building against the rising tide of energy performance in the form of Minimum Energy Efficiency Standards.

Our approach to pre-planning CAs

We are always pleased to undertake preliminary reviews at no cost in order to flag up the potential value of tax savings in a proposed project. This can be relatively high level, but can then move to a more detailed insight as the costings develop. Tax relief should not be the tail that wags the dog - but there are instances where modest changes can help optimise the savings - for example plenum ceilings or demountable partitioning systems.

About us

Between us the team at Afilia Capital Allowances have over fifty years of shared experience in advising on projects and preparing claims for Capital Allowances. All initial advice is provided at no cost and fees for certifications of allowances on completed projects are usually performance-based.

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