The new Full Expensing and First Year Allowance

From April 1st 2023

Afilia

Capital Allowances

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The key budget measures

In his first full budget as chancellor, Jeremy Hunt has opted for some key changes to the UK's system of Capital Allowances, and in this briefing we will look at its value to commercial property.

Since 2020 those corporate taxpayers incurring expenditure on improvement works have enjoyed temporary tax reliefs which accelerated the normal benefits by way of a 50% first year allowance on the Special Rate Pool (Integral Features), and the well-publicised Super Deduction of 130% on Main Pool items.

The government says that the latter has cost the Treasury £22m in the past two years and so there is an underlying wish to reduce this generosity.

As always, politicians have a tendency to view tax relief as tax leakage and ignore the receipts generated by the works. For example, VAT raised on materials plus National Insurance and income tax paid by everyone involved in the works undertaken.

In a study undertaken some years ago it was shown that the tax receipts generated by a new-build project over a ten year period dwarfed the value of the Capital Allowances, which equated to only around 5% of the total VAT, NI and income tax revenue created.

The permanent Annual Investment Allowance

Before going on to consider the new measures it is worth just recapping on the introduction in the 2022 autumn Budget Statement of a permanent £1m Annual Investment Allowance (AIA).

This is a form of First Year Allowance for plant & machinery and its level has been raised and lowered over the years. Its effect is to bring the first £1m of any plant & machinery claim into that year's tax computation - with any remaining balance then written down over time at the normal 6% and 18% rates.

In 2018 the AIA was raised from £200,000 to £1m for two years as a financial cushion to help businesses facing additional costs in preparing for leaving the EU. It was set to return to the £200,000 rate at the end of 2022, but the government relented and confirmed the £1m rate to be a permanent incentive for business.

The Full Expensing relief

This is the headline from the new Budget announcements on "Enterprise" and essentially works in the same way as the Super Deduction, by bringing all of the relief into the first year. As before, it applies only to corporate taxpayers and is available from 1st April 2023 until 31st March 2026.

Full Expensing applies to the Main or General Pool of allowances - which is essentially all of the equipment and fit-out in a building relating to the trade or business carried on. So for example; fitted joinery, staff facilities, blinds, carpets, data cabling - and a list extending to over 200 items - including door mats.

Plainly some businesses require greater levels of quality and quantity of fit-out and so offices, hotels, care homes etc will be likely to benefit from Full Expensing.

The 50% First Year Allowance

The Integral Features or Special Rate Pool is treated differently and carries forward the same arrangement as existed under the previous temporary tax reliefs - with a First Year Allowance of 50%. The remainder of a claim would then be subject to the annual 6% writing down rate.

For most taxpayers it will be possible to utilise the AIA to bring the other 50% of the value of a claim for Special Rate Pool items into the tax computation of the year the expenditure is completed. The 50% First Year Allowance is also available until March 2026.

Unincorporated taxpayers

It is important to note that the reliefs under the new system are not available to unincorporated taxpayers; e.g. partnerships or private individuals. While this may seem unfair it should be remembered that as 40% taxpayers, they receive significantly more value in tax savings than a company incurring the same expenditure.

Making claims

The new reliefs do not change any of the existing rules relating to the availability of Capital Allowances and so for all projects the analysis process remains unchanged. If anything the accelerated tax savings underline the importance of a detailed cost segregation exercise if a claim is to be optimised.

Date of first use

A key point is that where a building is either new or being refurbished, then in most instances the claim for Capital Allowances will only be available after the plant & machinery is brought into use for the first time. This makes March 31st 2026 an important deadline to be considered from the outset of any scheme. Project planning should start with that date as the latest possible time for completion. Many construction companies have busy order books, and so early preparation is crucial if the services of a preferred contractor are to be secured. Also, the joint impact of the pandemic and leaving the EU has made supply chains more fragile, with some risk of potential time-slippage on projects.

Commercial office £5m refurbishment			
	Expenditure	**Tax relief**	**First year claim**
Project cost	£5,000,000		
Repairs	£250,000	100%	£250,000
Integral Features (IF)	£1,600,000	50% FYA	£800,000
AIA on rest of IF		Up to £1,000,000	£800,000
Fit-out (Main Pool)	£1,500,000	100%	£1,500,000
Total claim			**£3,350,000**
		Tax saving at 25%	**£837,500**
		Project cost saving	**17%**

An investment perspective

Whilst the loss of the Super Deduction is regrettable, the increase in the rate of corporation tax means the net value of tax savings is almost identical. From an historical perspective these are still probably the most generous tax-breaks ever available to commercial property. For this reason there is a real impetus particularly for portfolio owners to review their assets and consider what possible expenditures might be necessary in the foreseeable future - and perhaps look to undertake the works within the next three years. If a potential sale is likely and some improvements will maximise the disposal value, then making an earlier start has obvious benefits.

Energy performance

We have written previously about potential changes to the minimum thresholds under the Minimum Energy Efficiency Standards (MEES). It had widely been expected that changes would be announced during 2022 - but this has been pushed back to align with the government's net-zero strategy review. Nevertheless no-one can realistically expect any back-pedalling on the identified need to reduce energy wastage in commercial property. The proposals under consideration are an increase to a minimum standard of EPC level 'C' by 2027 and to level 'B' by 2030.

This may prove costly for many owner-occupiers and investors and so utilising tax reliefs to underpin the cost of upgrades is an obvious opportunity not to missed.

Taking advantage of these extended reliefs may be very useful in helping future-proof buildings - as well as improving their marketability. Improvements that uplift an EPC rating are likely to be helpful in protecting asset values in the future.

The value of pre-planning

The chart shows the possible outcome of a £5m office refurbishment. Expenditure on qualifying repairs remains as a current year revenue expense. Integral Features shows a split treatment with 50% taken as a First Year Allowance and the balance claimed under the AIA.

The Main Pool items are covered by Full Expensing and claimed entirely in the first year.

In total the effect of the combined reliefs is a 17% saving on the project cost in the first year.

Where there is more tax relief than profits to offset, the unused relief will roll forward in the company accounts until used up.

Disclaimer: this article is not a substitute for professional advice

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