*These notes refer to the Capital Allowances Act 2001 (c.2) which received Royal Assent on 22nd March 2001*

# CAPITAL ALLOWANCES ACT 2001

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

***Glossary***

**Part 2: Plant and machinery allowances**

***Chapter 4: First-year qualifying expenditure***

**Overview**

206. This Chapter defines qualifying expenditure which gives entitlement to first-year allowances (subject to the person owning the plant or machinery in question in the chargeable period the expenditure is incurred – see section 52).

207. Section 39 introduces the three categories of expenditure in chargeable periods covered by the Act which may give rise to first-year allowances.

208. Sections 40 to 43 deal with expenditure which qualifies as incurred for Northern Ireland purposes by small or medium-sized enterprises. The expenditure must be incurred on or before 11 May 2002. They also provide for allowances to be withdrawn in some circumstances if plant or machinery is subsequently used outside Northern Ireland.

209. Section 44 provides for first-year allowances for qualifying expenditure incurred by a small or medium-sized enterprise which is not expenditure on a long-life asset (see Chapter 10).

210. Section 45 provides for first-year allowances for qualifying expenditure incurred on or before 31 March 2003 by a small enterprise on information and communications technology.

211. Section 46 defines expenditure which is excluded from all three categories of first-year qualifying expenditure.

212. Sections 47 to 49 decide whether or not an enterprise is small or medium-sized.

213. Section 50 provides that section 12 does not affect when expenditure is treated as incurred for the purposes of deciding what is and is not first-year qualifying expenditure.

214. Section 51 provides for exchange of information in connection with section 40.

215. Provisions relating to first-year allowances for earlier years are preserved in paragraphs 46 to 51 of Schedule 3 for the purposes of the legislation for additional VAT liabilities.

***Section 39: First-year allowances available for certain types of qualifying expenditure only***

216. This section is based in part on section 22(1) of CAA 1990. But it is mainly drafted to introduce this Chapter. It sets out the different kinds of first-year qualifying expenditure so readers can see quickly if they are likely to have expenditure which qualifies.

217. The three types of expenditure in this section cover the overwhelming majority of practical circumstances. But a very small minority may also have first-year qualifying expenditure as a result of additional VAT liabilities. See section 236. It is also possible for entitlement to first-year allowances to arise in respect of additional VAT liabilities:

- in a chargeable period to which the Act applies; but
- under the provisions for first-year allowances for expenditure between 1992 and 1993 or between 1997 and 1998.

218. Additional VAT for those periods is likely to be a practical issue for very few people indeed in the chargeable periods covered by the Act. The provisions are only capable of having effect until the end of the period for VAT adjustments (5 or 10 years). So the necessary provisions are in paragraphs 46 to 51 of Schedule 3 to the Act.

### *Section 40: Expenditure incurred for Northern Ireland purposes by small or medium-sized enterprises*

219. This section is based on parts of section 22(3CA) and (3CB) of CAA 1990. It gives the conditions which must be met for first-year qualifying expenditure under this heading.

220. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise.

### *Sections 41 and 42: Exclusions from section 40*

221. These sections are based mainly on section 22(3CC), (3CE), (6D) and (6E) of CAA 1990. They exclude some expenditure from being first-year qualifying expenditure under section 40.

222. *Section 41* gives exclusions according to the nature of the expenditure.

223. *Section 42* excludes plant and machinery intended for use partly outside Northern Ireland if first-year allowances could be a main benefit of the expenditure qualifying.

### *Section 43: Effect of plant or machinery subsequently being primarily for use outside Northern Ireland*

224. This section is based on section 22B of CAA 1990. It stops expenditure being first-year qualifying expenditure under section 40 if there is a change in the use of the plant or machinery and withdraws any first-year allowances which have been made.

225. *Subsection (1)* withdraws entitlement to first-year allowances if plant or machinery is used or held for use primarily outside Northern Ireland in the period defined by subsections (2) and (3). That is five years from the date of the expenditure if it is over £3.5 million and two years if not.

226. *Subsection (4)* allows first-year allowances already made to be withdrawn.

227. *Subsections (5)* and *(6)* require taxpayers to notify the Inland Revenue within three months if, as a result of this section, their tax return needs amendment.

### *Section 44: Expenditure incurred by small or medium-sized enterprises*

228. This section is based on section 22(3D) of CAA 1990. It defines first-year qualifying expenditure for small or medium-sized enterprises.

229. Sections 47 to 49 decide whether or not expenditure is incurred by a small or medium-sized enterprise for the purpose of subsection (1)(b). Section 90 defines long-life asset expenditure.

### *Section 45: ICT expenditure incurred by small enterprises*

230. This section is based mainly on section 22(3E) to (3H) of CAA 1990. It provides first-year qualifying expenditure for expenditure by small enterprises on information and communications technology (ICT).

231. Sections 47 to 49 decide whether or not expenditure is incurred by a small enterprise for the purpose of subsection (1)(b).

### *Section 46: General exclusions applying to sections 40, 44 and 45*

232. This section brings together legislation in sections 22(6B) and (6C), 38, 50 and 81 of CAA 1990. These are general exclusions which stop expenditure being first-year qualifying expenditure.

233. The exclusions mostly relate to the type of plant or machinery bought or its use. Two which do not are worth noting:

- General exclusion 1 excludes from first-year qualifying expenditure any qualifying expenditure in the chargeable period in which there is a permanent discontinuance of a qualifying activity. This expenditure is fully relieved by a balancing allowance (or reduction in balancing charge) for the appropriate pool. Cutting out first-year allowances simplifies the route to tax relief; and

- General exclusion 8 excludes from first-year qualifying expenditure any qualifying expenditure a person is treated as incurring if they bring into use plant or machinery:

  — previously not used for that qualifying activity; or

  — received as a gift.

  First-year allowances may already have been given for this plant or machinery when it was originally bought. But an exception to this is made for certain pre-trading expenditure on mineral exploration and access if a person is treated as having sold and bought plant or machinery.

234. It might be thought that the reference in general exclusion 7 to a "trade or business" should be to a "qualifying activity or business". However, in the context of section 22(6C) of CAA 1990 from which this comes, the phrase "trade or business" translates into this Act so as to make neither wider nor narrower the scope of this exclusion. See *Note 14* in Annex 2.

### *Sections 47 to 49: Expenditure of small or medium-sized enterprises*

235. These three sections are based on sections 22A and 22AA of CAA 1990. They set out how to decide if a company or other business is a small or medium-sized enterprise for the purposes of the legislation for first-year qualifying expenditure.

236. *Section 47* deals with expenditure by companies. As in other sections, the reference to the companies legislation avoids duplication in this Act and makes clear the tests are precisely the same. For ease of reference here the Companies Act 1985 provides:

**Section 247: Qualification of company as small or medium-sized**

"(1) A company qualifies as small or medium-sized in relation to a financial year if the qualifying conditions are met—

(a) in the case of the company's first financial year, in that year, and

(b) in the case of any subsequent financial year, in that year and the preceding year.

(2) A company shall be treated as qualifying as small or medium-sized in relation to a financial year—

(a) if it so qualified in relation to the previous financial year under subsection (1) above or was treated as so qualifying under paragraph (b) below; or

(b) if it was treated as so qualifying in relation to the previous year by virtue of paragraph (a) and the qualifying conditions are met in the year in question.

(3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

| | |
|---|---|
| **Small company** | |
| 1 Turnover | Not more than £2.8 million |
| 2 Balance sheet total | Not more than £1.4 million |
| 3 Number of employees | Not more than 50 |
| **Medium-sized company** | |
| 1 Turnover | Not more than £11.2 million |
| 2 Balance sheet total | Not more than £5.6 million |
| 3 Number of employees | Not more than 250. |

237. These limits can be changed by statutory instrument. The last change was in 1992.

238. The same tests are used in the Companies (Northern Ireland) Order 1986.

239. *Subsections (2)(b)* and *(3)(b)* stop companies qualifying as small or medium-sized if they are members of a larger group. See section 49.

240. *Section 48* deals with expenditure by businesses which are not companies. The test is broadly whether the business would be a small or medium-sized company if the qualifying activity were carried on by a company. This is done by looking at whether or not a hypothetical company would be small or medium-sized.

241. *Subsection (2)* applies the section to businesses carried on by individuals and to others that are not companies and so would otherwise not be able to have first-year qualifying expenditure.

242. *Subsection (5)* sets the assumptions for the hypothetical company which is used to decide if the business is small or medium-sized. These include the assumption that every trade, business, profession or vocation carried on by the business is carried on by the business as part of that activity. This is broadly equivalent to the requirement in section 47(2)(b) that a company is not a member of a large group.

243. *Subsections (6)* and *(7)* then use the relevant companies legislation to decide if the hypothetical company is small or medium-sized.

244. *Subsections (8)* and *(9)* decide the relevant companies legislation for this purpose. They make minor changes to make clear whether the Companies Act or the Northern Ireland legislation should be used for this purpose. The difference does not matter in practice as the legislation is very similar. See *Change 7* in Annex 1.

245. *Section 49* decides if a company is a member of a large or medium-sized group for the purposes of section 47.

246. *Subsection (4)* treats as large or medium-sized a company which is not but would be if arrangements which already exist would make it, or a successor to its trade, large or medium-sized.

247. *Subsections (5)* and *(6)* apply the relevant companies legislation.

**Section 249(3) Companies Act 1985**

“(3) The qualifying conditions are met by a group in a year in which it satisfies two or more of the following requirements—

| | |
|---|---|
| **Small group** | |
| 1. Aggregate turnover | Not more than £2.8 million net (or £3.36 million gross) |
| 2. Aggregate balance sheet total | Not more than £1.4 million net (or £1.68 million gross) |
| 3. Aggregate number of employees | Not more than 50 |
| **Medium sized group** | |
| 1. Aggregate turnover | Not more than £11.2 million net (or £13.44 million gross) |
| 2. Aggregate balance sheet total | Not more than £5.6 million net (or £6.72 million gross) |
| 3. Aggregate number of employees | Not more than 250. |

248. These limits can be changed by statutory instrument. The last change was in 1992.

### *Section 50: Time when expenditure is incurred*

249. This section is based on parts of section 22 of CAA 1990. It disregards the legislation which treats expenditure incurred before a qualifying activity starts as incurred in its first chargeable period (see paragraph 120 above). It is the actual date expenditure is incurred which matters for entitlement to first-year allowances.

### *Section 51: Disclosure of information between UK tax authorities*

250. This section is based on section 22C of CAA 1990. It allows information to be exchanged by the Inland Revenue and the Department of Agriculture and Rural Development in Northern Ireland in connection with the administration of first-year allowances for expenditure by small or medium-sized enterprises for Northern Ireland purposes.