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

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Plant and machinery allowances

Chapter 5: Allowances and charges

Overview

251. This Chapter makes general provision for the calculation of allowances and charges under this Part. Its provisions are subject to adaptations and modifications provided in the following Chapters. They make special provisions for particular types of asset.

252. Section 52 gives the amount of first-year allowance a person is entitled to in a chargeable period if they incur first-year qualifying expenditure and own the plant or machinery. The person may then claim first-year allowances for the whole or part of first-year qualifying expenditure.

253. Sections 53 and 54 require expenditure to be pooled to decide entitlement to allowances or liability to balancing charges. Allowances may be writing-down allowances or balancing allowances. There are single asset pools, class pools and a main pool. Later Chapters define which expenditure must be allocated to a class or single asset pool. Only expenditure which is not allocated to a class or single asset pool is allocated to the main pool. If a person carries on more than one qualifying activity, there are separate pools for each activity.

254. Sections 55 and 56 decide entitlement to an allowance or liability to a charge for each pool for a chargeable period. This depends on the difference between the available qualifying expenditure (AQE) for a pool for the chargeable period and the total of any disposal receipts to be brought into account (TDR):

   - if AQE exceeds TDR, the person is entitled to an allowance. The entitlement is to a writing-down allowance except in the final chargeable period of the pool when it is to a balancing allowance. The rate of writing-down allowances is 25% except for long-life assets (6%) and overseas leasing (10%);
   - if TDR exceeds AQE, the person is liable to a balancing charge equal to the difference.

255. Sections 57 to 59 give the general rules for AQE and pointers to other provisions which affect it. The general rule is that AQE for a pool is the qualifying expenditure allocated to the pool for the chargeable period (section 58) plus any unrelieved qualifying expenditure brought forward from the previous chargeable period (section 59).

256. Section 60 defines “disposal receipt” and “disposal event”:

- a disposal receipt is the amount of any disposal value a person must bring into account;
- a disposal event is an event of the type which requires a person to bring a disposal value into account.

257. General disposal events and disposal values are listed in section 61; there are others elsewhere.

258. Sections 63 to 65 restrict disposal values in some cases. There is a general limit equal to the qualifying expenditure incurred by the person (or in some cases a connected person). The disposal value is nil for some gifts. It is also nil if no first-year allowance is made and no qualifying expenditure is allocated to a pool (subject to additional conditions if the plant or machinery is acquired from a connected person).

259. Section 65 gives the general rules for when there is a final chargeable period for a pool.

260. Section 66 gives pointers to some other provisions dealing with disposal values.

Section 52: First-year allowances

261. This section is based mainly on section 22(1) of CAA 1990. It gives entitlement to first-year allowances.

262. *Subsection (1)* gives entitlement to first-year allowances if a person both incurs first-year qualifying expenditure in a chargeable period and owns the plant or machinery in that chargeable period.

263. *Subsection (2)* makes clear that any first-year allowance is made for the chargeable period in which the expenditure is incurred.

264. *Subsection (3)* gives the rates of first-year allowances.

265. *Subsection (4)* allows a person to claim first-year allowances for only some (including none) of their first-year qualifying expenditure. This is more direct than section 22(7) of CAA 1990. That permits a person to require that the amount of the allowance, or aggregate amount of the allowances, be reduced to an amount specified in that claim. The ability to do so helps people who might otherwise face a balancing charge in the same chargeable period. They can then add some or all of the first-year qualifying expenditure to their pool for the current chargeable period (see paragraph 295 below).

266. Section 22(7) of CAA 1990 deals with the aggregate of allowances to keep the sums simple. Section 52 gives people the option of doing that in practice by claiming for the same proportion of all first-year qualifying expenditure or of claiming for different proportions of different items of expenditure.

267. Section 22(7) does not permit a claim for reduced first-year allowances for ships. But section 30(1)(b) of CAA 1990 makes equivalent provision.

268. Section 22(7) and 30(1) require the claim to specify the reduced allowance required. Subsection (4) achieves this more directly by dealing with qualifying expenditure. See *Note 15* in Annex 2.

269. *Subsection (5)* gives signposts to other provisions which may affect first-year allowances.

Example

Assume P:

starts trading as a plumber on 6 April 2002;

prepares accounts to 5 April each year; and

buys during 2002-03 a van for £5,000 and a computer for £1,000 for use wholly and exclusively for business purposes.

P has for the year ending 5 April 2003:

£5,000 first-year qualifying expenditure under section 44 (expenditure incurred by small or medium-sized enterprises) on which P can claim allowances of £5,000 x 40% = £2,000; and

£1,000 first-year qualifying expenditure under section 45 (ICT expenditure incurred by small enterprises) on which P can claim allowances of £1,000 x 100% = £1,000.

But P does not have to claim these first-year allowances. If, for example, P has income only £1,000 greater than the personal allowance then P might decide to claim first-year allowances of £1,000 in respect of only half the expenditure on the van and none in respect of the expenditure on the computer.

Section 53: Pooling of qualifying expenditure

270. This section makes explicit that qualifying expenditure must be pooled to arrive at writing-down allowances and balancing allowances or balancing charges.

271. As noted in paragraph 98 above, Part II of CAA 1990 does not refer to pools as such. Expenditure is pooled by requiring it to be aggregated for the purposes of working out writing-down allowances, balancing allowances and charges for each trade, deemed trade or notional trade. In this Act these requirements are expressed in terms of pools for qualifying activities.

272. *Subsection (2)* requires that expenditure for separate qualifying activities must be allocated to separate pools. So a person carrying on several qualifying activities may have several main pools and class pools plus separate sets of single asset pools.

Section 54: The different kinds of pools

273. This section sets out explicitly the different types of pool. In CAA 1990 the class pools and single asset pools are notional trades. The main pool is the default for the actual trade – or the activity treated as a trade.

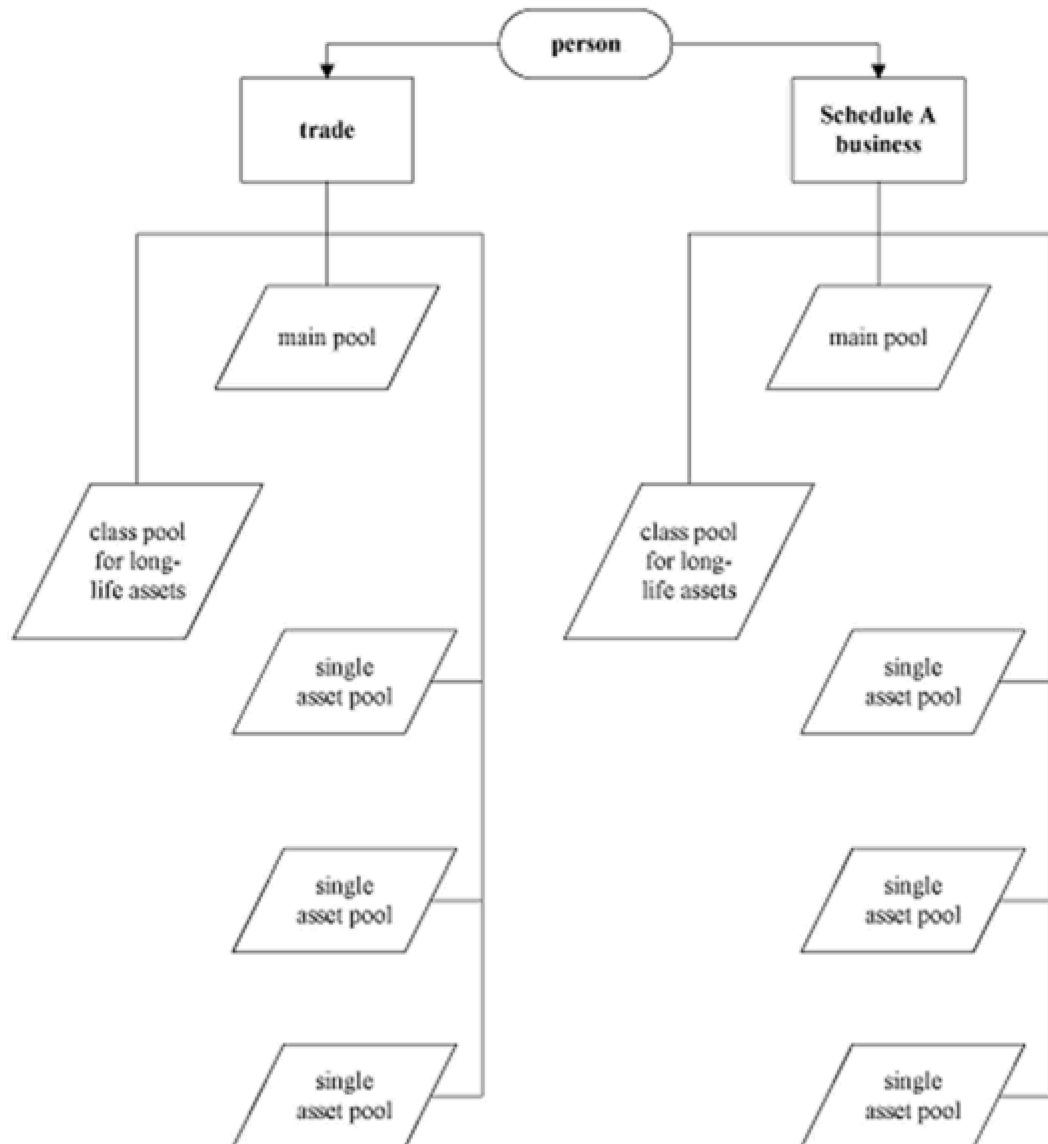
274. *Subsection (2)* provides that a single asset pool cannot contain expenditure in respect of more than one asset. CAA 1990 achieves this by creating a notional trade for expenditure on the provision of an asset separate from any other trade carried on.

275. *Subsection (3)* points to provisions which determine if qualifying expenditure has to be allocated to a single asset pool (if it is allocated to a pool).

276. *Subsection (4)* and *(5)* provide similarly for class pools.

277. *Subsection (6)* provides what is the default rule in CAA 1990. This is that expenditure can only be allocated to the main pool if it does not have to be allocated to a class or single asset pool.

Figure 2: example of requirement that expenditure relating to the different activities must not be allocated to the same pool.



Section 55: *Determination of entitlement or liability*

278. This section is based on section 24(2) and (5) of CAA 1990. It decides whether a pool gives rise to entitlement to an allowance or liability to a charge.

279. The amounts of available qualifying expenditure (AQE) and total of any disposal receipts (TDR) are not defined until later in this Chapter. But putting this section here lets readers see why they matter:

- if AQE is greater than TDR, they are entitled to claim an allowance; and
- if AQE is less than TDR, they are liable to a balancing charge.

Section 56: *Amount of allowances and charges*

280. This section is based mainly on section 24(2), (3) and (5) of CAA 1990. It decides the amount of any allowance a person is entitled to claim for a pool or the charge for which they are liable.

281. *Subsections (1)* to *(4)* deal with writing-down allowances. The amount is generally 25% of the excess of AQE over TDR, adjusted up or down if the chargeable period is more or less than a year and/or the qualifying activity is carried on for less than the whole chargeable period. For the class pool for long-life assets the rate is 6%. For the class pool for overseas leasing it is 10%.

282. *Subsection (5)* allows a person to claim less than their full entitlement to a writing-down allowance. Section 24(3) expresses this differently. It requires a person to claim the allowance and to require it to be reduced to a specified amount. But the effect is the same.

283. *Subsection (6)* provides that if TDR is greater than AQE, the balancing charge is the excess: that is TDR-AQE.

284. *Subsection (7)* provides that if:

- AQE is greater than TDR; and
- it is the final chargeable period for a pool,

then the balancing allowance is the excess: that is AQE-TDR.

285. Both a balancing charge and a balancing allowance have the effect, in colloquial terms, of “emptying the pool”.

Section 57: Available qualifying expenditure

286. This section is based on section 25(1) of CAA 1990 which gives the general rule as to what is (in this Act) available qualifying expenditure. But it includes additional pointers to other provisions.

287. *Subsection (1)* gives the general rule. This is that AQE is the sum of:

- qualifying expenditure allocated to the pool in the chargeable period; and
- unrelieved qualifying expenditure brought forward from the pool from the previous chargeable period.

288. *Subsections (2)* to *(4)* point to other provisions which may affect AQE.

Section 58: Initial allocation of qualifying expenditure to pools

289. This section is based in part on section 25 of CAA 1990 and section 118(6) of FA 1994. There are also minor changes in the law. The section sets out the rules for what qualifying expenditure can be allocated to a pool and when.

290. *Subsection (1)* introduces the rules. It leaves implicit that a person is generally free to allocate or not allocate qualifying expenditure to the appropriate pool subject only to the detailed rules. (The “appropriate pool” is defined in subsection (8) as that which this Part requires.)

291. This flexibility over the allocation of qualifying expenditure is a change in the law. On close examination section 25(1) of CAA 1990 requires expenditure to be allocated to a pool in the first chargeable period it can be. This would be the chargeable period it is incurred unless first-year allowances are made. In that case it would be the next chargeable period. However the approach taken in this section is in keeping with the generally prevailing practice and maintains the flexibility taxpayers have had in practice to add qualifying expenditure in a later chargeable period (whether by design or because it was accidentally omitted in an earlier chargeable period). See *Change 8* in Annex 1.

292. *Subsection (2)* prevents qualifying expenditure being used twice.

293. *Subsection (3)* prevents qualifying expenditure being allocated to a pool before it has been incurred.

294. *Subsection (4)* prevents qualifying expenditure being allocated to a pool unless the person owns the plant or machinery at some time in the chargeable period. This is based on section 118(6) of FA 1994.

295. *Subsection (5)* means that:

- qualifying expenditure cannot be allocated to a pool for a chargeable period for which a first-year allowance is made on it – this may be only be part of the qualifying expenditure on the plant or machinery because of section 52(4); but
- the balance of qualifying expenditure less first-year allowances can then be allocated to a pool in any later chargeable period (subject to the other rules such as the person still owning the plant or machinery).

296. This incorporates minor changes in the law which make the legislation more flexible. Again, see *Change 8* in Annex 1. In summary subsection (5):

- drops the requirement in section 25(3) of CAA 1990 that taxpayers must elect by notice to the Inland Revenue if they wish to allocate first-year qualifying expenditure to a pool for the chargeable period they incur it; and
- leaves the balance of qualifying expenditure less first-year allowances made to be allocated to the appropriate pool as and when the taxpayer wishes (subject of course to the other rules).

297. *Subsection (6)* is based on section 25(5). It allows the balance of first-year qualifying expenditure less first-year allowances made to be added to the appropriate pool if there is a disposal event in the same chargeable period. That way the net cost of the plant or machinery is taken into account either by way of first-year allowances or in the pool.

298. It is up to the taxpayer to choose how much of the balance of first-year qualifying expenditure is added to the pool. Normally it will be all of the expenditure. But subsection (6) requires that at least some qualifying expenditure is allocated to the pool; and subsection (7) adds that this may even be a nil amount. This is a necessary corollary to section 64 in which this Act provides that a person does not have to bring a disposal value into account if they have allocated no expenditure to the pool. (Without the rule in subsections (6) and (7), a person might for example buy plant or machinery for £100, sell it for £90 and be left with £100 first-year allowances when the net cost is only £10.) See *Change 8* in Annex 1.

299. Section 220 makes further provision about the allocation of qualifying expenditure in relation to finance leases.

Example

Assume P incurs in 2002-03 first-year qualifying expenditure of:

£5,000 on a van but takes first-year allowances on only £2,500; and

£1,000 on a computer but takes first-year allowances on none of that expenditure. (See example on page 41 above.)

Then P can allocate to the main pool for the plumbing trade for 2002-03:

£2,500 in respect of the van; and

£1,000 in respect of the computer.

This gives available qualifying expenditure of £3,500 in total. P is entitled to claim allowances on this at 25% (see section 56). But P is not required to do so.

Section 59: Unrelieved qualifying expenditure

300. This section is based on parts of sections 24(1) and 25(1) of CAA 1990. It defines the unrelieved qualifying expenditure a person carries forward from a chargeable period.

301. *Subsection (3)* provides that no unrelieved qualifying expenditure can be carried forward from the final chargeable period of a pool. This is implicit in CAA 1990. See *Note 16* in Annex 2.

Example

Assume in the example above that P claims writing-down allowances of £3,500 x 25% = £875.

Then P carries forward £3,500 - £875 = £2,625 unrelieved qualifying expenditure to 2003-04.

P can also allocate to the pool for 2003-04 the balance of the first-year qualifying expenditure on the van on which first-year allowances were claimed (see section 58(5)): £2,500 - £1,000 = £1,500.

So assuming no other expenditure and no disposals P has for 2003-04 available qualifying expenditure (see section 57):

qualifying expenditure allocated to the pool for 2003-04	£1,500
unrelieved qualifying expenditure carried forward	£2,625
	______
available qualifying expenditure	£4,125

Section 60: Meaning of "disposal receipt" and "disposal event"

302. This section is based in part on section 24(6) of CAA 1990. It defines two terms used in this Part.

303. CAA 1990 refers to disposal values. The disposal value there is, broadly, the amount a person may have to bring into account in a pool on the occurrence of various events. But there is no simple term for those events. Nor is the disposal value always the amount actually brought into account. It may for example be limited by section 26(2) of CAA 1990 (see section 62).

304. In the interests of clarity this section defines:

- disposal receipt to mean the amount actually brought into account as a result of a disposal event – the amount which feeds into TDR. The disposal receipt may be less than the disposal value; and
- disposal event to refer to the events of the type which require a disposal value to be brought into account.

305. *Subsection (3)* is based on section 24(6) of CAA 1990. It prevents more than one disposal value being brought into account for the same expenditure on the same plant or machinery in the same pool. This makes clear what has long been the understanding of section 24 of CAA 1990 and the practice. See *Change 9* in Annex 2.

306. However, a person may be required to bring more than one disposal value into account in respect of the same plant or machinery in some circumstances. For example if they buy, sell and buy again the same plant or machinery in one chargeable period there will be two disposal values for the two separate amounts of qualifying expenditure.

307. Similarly there may be disposal values in respect of the same plant or machinery in different pools in the same chargeable period.

Example

A person starts to use plant and machinery partly for non-trade purposes. This requires a disposal value (open market value) to be brought into account. But it also creates a new pool with qualifying expenditure equal to the open market value. (See Chapter 15).

The person then sells the plant or machinery. This requires another disposal value to be brought into account. But that is in the separate, new pool.

Section 61: Disposal events and disposal values

308. This section is based on sections 24(6) and 26(1) of CAA 1990. It gives the general disposal events and the disposal values to go with them.

Example

The assumptions are as in the example for section 59 on page 47 except that P sells the van on 1 March 2004 for £3,000. This is an arm's length sale at market value. The disposal value is £3,000.

For 2003-04 P has:

available qualifying expenditure of £4,125; and

total of any disposal receipts of £3,000;

and, as AQE exceeds TDR, is entitled to writing-down allowances at 25% on £4,125 - £3,000 = £1,125

309. Item 2 in the Table provides for the market value to be found at the time of the sale. CAA 1990 is silent on this. But it is implicit. See *Note 17* in Annex 2.

310. There is a minor change. Item 5 in the Table gives a disposal value which is not in CAA 1990 in relation to the abandonment of certain plant or machinery. Section 24(6)(c)(ii) of CAA 1990 gives this disposal event. But section 26 of CAA 1990 does not give a disposal value for that specific event. In the absence of any specific disposal value within section 26(1), the disposal value is given by section 26(1)(f). It is the open market value of the plant or machinery. This is at odds with the treatment of other plant or machinery when it is demolished or possession is lost; with the treatment of plant or machinery that is dismantled or demolished as part of a decommissioning programme; and it is uncertain. Item 5 in the Table accordingly provides for the disposal value to be the insurance or other compensation received. See *Change 10* in Annex 1.

Section 62: General limit on amount of disposal value

311. This section is based on section 26(2) and (3) of CAA 1990 with a minor change. It puts a cap on disposal values.

312. *Subsection (1)* is the general rule. It is based on section 26(2) of CAA 1990. The disposal value for any plant or machinery is limited to the qualifying expenditure incurred on it. This is part of the underlying theme of this Part: plant and machinery allowances are given in total for the actual depreciation suffered on the asset. Without this provision someone who (exceptionally) sells plant or machinery for more than they paid for it would end up with an overall charge.

313. *Subsections (2)* and *(3)* modify the general rule concerning plant or machinery acquired from a connected person. They are based on section 26(3) of CAA 1990. They limit the disposal value to the greatest amount of qualifying expenditure incurred by any of

those connected persons. This rule goes hand in hand with the provisions in section 61 which allow a person to:

- sell at less than market value to a connected person who can claim capital allowances; and
- bring only the sale proceeds into account as a disposal value (rather than the open market value).

314. Without subsections (2) and (3) people could avoid balancing charges, if allowances exceeded the actual depreciation, by selling to a connected person who then sells the plant or machinery.

315. The rules are expressed in this section in terms of qualifying expenditure. Section 26(2) and (3) of CAA 1990 gives the rule in terms of capital expenditure. This is a change which is in principle generally favourable to taxpayers. It leaves out of account capital expenditure incurred by a connected person who is not carrying on a qualifying activity. It can in theory have a knock-on effect which is against a taxpayer's interests if the disposal comes within Chapter 17. This is because the benefit for the seller of a lower disposal value may then result in a lower amount of qualifying expenditure for the buyer. See *Change 11* in Annex 1.

316. Section 575 defines a "connected person".

Section 63: Cases in which disposal value is nil

317. This section is based on parts of sections 24, 67, 69, 70 and 71 of CAA 1990 and of sections 21A, 65A, 70A, 83A and 84 of ICTA. It also makes minor changes. It provides a nil disposal value for a number of disposal events.

318. *Subsection (1)* is based on section 24(6) of CAA 1990. That provides that:

"this subsection shall not require a person to bring into account the disposal value of any machinery or plant which he disposes of by way of gift in such circumstances that there is a charge to tax under Schedule E.

319. This provision has in the past caused some confusion. It was sometimes read as meaning that there was no disposal event at all. That is not right. But the absence of a disposal value still has some odd effects. For example suppose a person buys plant or machinery, claims first-year allowances and then gives it to an employee in the same chargeable period. On the basis of CAA 1990 they would not be entitled to allocate the balance of their qualifying expenditure to a pool. Subsection (1) provides a nil disposal value which allows them to do so. It also makes clearer the effect of the legislation. This could be to the disadvantage of the recipient if the gift were a transaction within Chapter 17 as it prevents the recipient from also claiming allowances. But this is thought to be unlikely in practice. See *Change 12* in Annex 1.

320. *Subsection (2)* makes similar provision for gifts to certain charities, heritage and other bodies, and educational establishments. This is based on parts of sections 83A and 84 of ICTA. They provide that section 24 of CAA 1990 does not require a disposal value to be brought into account. Subsection (2) makes a minor change, as in subsection (1), to provide a nil disposal value with similar effects. See *Change 12* in Annex 1.

321. *Subsection (2)* also omits the requirements in section 84 of ICTA that the person making the gift must have claimed plant and machinery allowances and make a claim for the relief section 84 provides. This is in principle in taxpayers' favour but is very unlikely to make any practical difference. It does however simplify the legislation for gifts to educational establishments and bring it into line with the more modern legislation in section 83A of ICTA which has neither of these requirements. See *Change 13* in Annex 1.

322. *Subsection (3)* lists the qualifying activities which get the benefit of a nil disposal value for gifts within subsection (2). This is based partly on sections 83A and 84 of ICTA. Those sections refer explicitly to trades, professions and vocations. But the effect of other provisions in ICTA is that Schedule A businesses and overseas property businesses are also included. It might be thought that other qualifying activities were also covered for the purposes of plant and machinery allowances. But there is no provision in ICTA which extends sections 83A and 84 to them. See *Note 18* in Annex 2.

323. *Subsection (4)* points to the provisions in ICTA which impose a charge on donors if they or persons connected with them receive any benefit from the gift.

324. *Subsection (5)* provides nil disposal values for expenditure of the types dealt with by section 27. CAA 1990 has the same provisions in sections 67 and 69 to 71.

Section 64: Case in which no disposal value need be brought into account

325. This section is a minor change. It provides that no disposal value need be brought into account in respect of qualifying expenditure if no first-year allowances have been made and no expenditure has been allocated to a pool.

326. There is no explicit provision in CAA 1990 equivalent to this section. It is, however, in line with practice.

327. On the basis that section 25(1) of CAA 1990 requires expenditure to be allocated automatically to a pool, there would be little need for such a provision given that the disposal value is limited to the capital expenditure incurred. But a taxpayer would appear to be required to bring a disposal value into account even if they had not appreciated they had qualifying expenditure and had made no use of it. CAA 1990 also leaves unclear what taxpayers should do if a change in the accepted meaning of plant or machinery results in their having disposal values to bring into account for what they never knew was expenditure on plant or machinery.

328. In practice the Inland Revenue have accepted that expenditure which is not added to the pool, for whatever reason, may be added for a later period provided there has not been a disposal event. This more flexible approach is followed in this Act. The Inland Revenue have also accepted that no disposal value need be brought into account if no first-year allowances have been made and none of the expenditure has been allocated to a pool.

329. Subsection (1) puts this on a clearer statutory basis. It provides that no disposal value need be brought into account if no expenditure is allocated to a pool (which, when read with section 58(6), means also that no first-year allowances are made). See *Change 14* in Annex 1.

330. *Subsections (2)* to *(4)* are consequential on the change in subsection (1). They require a person ("C") who has qualifying expenditure for plant or machinery acquired from a connected person to bring into account a disposal value if:

- C allocates any qualifying expenditure to a pool (or gets first-year allowances); or
- any of the connected persons in the transaction or train of transactions before C brings into account a disposal value.

331. The first is no more than the general rule. The second prevents the minor change in subsection (1) being used by connected persons to escape bringing into account disposal values on plant or machinery for which allowances are claimed. See again *Change 14* in Annex 1.

332. Section 575 defines a "connected person".

Section 65: The final chargeable period

333. This section is based on the several provisions throughout Part II of CAA 1990 which deal with pools. There are also two minor changes. It defines the final chargeable period for pools. A final chargeable period means there may be entitlement to a balancing allowance (see section 56).

334. *Subsection (1)* means there is a final chargeable period for the main pool for the qualifying activity of special leasing when the special leasing ends. This is not clear in section 61 of CAA 1990 but is what one would expect from the underlying approach in Part II of CAA 1990. It avoids anomalies such as a pool with no end; and allowances which cannot be used against any income whatsoever. See *Change 15* in Annex 1.

335. *Subsection (2)* provides a final chargeable period for a single asset pool when there is a disposal event. But this is subject to the additional provisions pointed to in subsection (3). This is based on parts of sections 24, 31, 34, 37, 79 and 80 of CAA 1990. They provide for the notional trades (pools here) to be permanently discontinued. Most use a common form of words:

"without prejudice to section 24(6)(c)(i) to (iii), the [notional] trade is permanently discontinued when the [plant or machinery] begins to be used wholly or partly for purposes other than those of the actual trade

336. Section 24(6)(c)(i) to (iii) of CAA 1990 lists disposal events and has been taken to mean the pool ends with a final chargeable period when such an event occurs. Subsection (2) provides for this. See *Change 15* in Annex 1.

Section 66: List of provisions outside this Chapter about disposal values

337. This section sets out provisions elsewhere in Part 2 about disposal values.