These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 5: Annual Investment Allowance

Summary

1. Section 5 provides legislation to increase the amount of the entitlement to annual investment allowance (AIA) from £50,000 to £100,000. The legislation is effective for expenditure incurred on or after 1 April 2010 for persons within the charge to corporation tax (CT) and on or after 6 April 2010 for persons within the charge to income tax.

Details of the Section

2. Subsection (1) amends subsection (5) of section 51A of the Capital Allowances Act 2001 (CAA) so that the maximum AIA that can be claimed for a 12 month chargeable period is increased from £50,000 to £100,000.

3. Subsection (2) provides that the increase in the limit has effect in relation to expenditure incurred on or after the relevant date. "Relevant date" is defined in subsection (6) as 1 April 2010 for CT purposes and from 6 April 2010 for income tax purposes.

4. Subsection (3) provides that where a chargeable period spans the relevant date then subsections (4) and (5) apply.

5. Subsection (4) provides that the maximum allowance is the sum of each maximum allowance that would be found if the actual chargeable period were split into two chargeable periods. The first beginning with the first day of the chargeable period and ending with the day before the relevant date. The second beginning on the relevant date and ending with the last day of the chargeable period.

6. So where a business has a chargeable period that spans the relevant date of the increase, the maximum allowance for that business's transitional chargeable period is the sum of:

   (a) the maximum AIA entitlement, based on the previous £50,000 annual cap for the portion of a year falling before the relevant operative date; and

   (b) the maximum AIA entitlement, based on the new £100,000 cap for the portion of a year falling on or after the relevant date.

7. For example, a company with a calendar year chargeable period from 1 January 2010 to 31 December 2010 would calculate its maximum AIA entitlement based on:

   (a) the proportion of a year from 1 January 2010 to 31 March 2010, that is, 3/12 x £50,000 = £12,500; and

   (b) the proportion of a year from 1 April 2010 to 31 December 2010, that is 9/12 x £100,000 = £75,000.

The company's maximum AIA for this transitional chargeable period would therefore be the total of (a) + (b) = £12,500 + £75,000 = £87,500.

8. Subsection (5) effectively provides that in the part of the chargeable period falling before 1 April 2010, only a maximum of £50,000 of the company's expenditure would be covered (in other words the previous AIA limit would apply). Returning to the example above, this rule does not affect the business's maximum AIA for the chargeable period as a whole (which is £87,500) simply the amount of expenditure before the relevant start date that may be covered.

9. For example, a company with a calendar year chargeable period would have a maximum entitlement under subsection (4) of £87,500, but if the company spent, say, £70,000 in February 2010 and incurred no other qualifying expenditure for the remainder of the year the maximum AIA available to that company would be £50,000.

Background Note

10. The AIA was introduced in the Finance Act 2008. It is effectively a 100 per cent capital allowance available on most plant and machinery (although it is not available on cars) up to an annual limit, which was originally £50,000.

11. The AIA is available to most businesses, both incorporated and unincorporated, regardless of size. Any expenditure by businesses over the annual limit will attract writing-down allowances (WDAs) at either 20 per cent or 10 per cent per annum in the normal capital allowances regime. The AIA is given for a chargeable period and the annual limit is increased or decreased proportionately when the chargeable period is longer than or shorter than 12 months.

12. The introduction of the AIA represented a major simplification of the tax system, as the vast majority of UK businesses invest less than the upper limit of £50,000 and so, in time, will have no need to calculate WDAs annually. The AIA offers a generous cash flow advantage to businesses (in comparison to WDAs) and therefore acts as a significant incentive to invest in plant and machinery.

13. The AIA is available to:

- any individual carrying on a qualifying activity (this includes trades, professions, vocations, ordinary property businesses and individuals having an employment or office);
- any partnership consisting only of individuals; and
- any company (subject to certain restriction).

14. In the case of companies in a group there is one AIA available to all the companies in the group.

15. In the case of singleton companies, each receives its own AIA unless, for example, it and another company are under common control. Where companies are under common control (for example, two companies owned by the same individual) each company will still be entitled to a separate £50,000 AIA, unless they are "related".

16. The legislation provides that a company is related to another company in a financial year and, separately, that an unincorporated qualifying activity is related to another qualifying activity in a tax year, if either or both of:

- the shared premises condition; and
- the similar activities condition

are met in relation to the companies or the qualifying activities in that financial year or that tax year, as the case may be.

17. The rules provide businesses with almost complete freedom to allocate the AIA between different types of expenditure. For example, they may allocate it first against any expenditure on "integral features", qualifying for the lower ten per cent "special rate" of WDA.

18. The rules also allow the persons in control the freedom to allocate the AIA between companies in a group or between "related" companies. There is a similar freedom in relation to the allocation of the AIA between "related" unincorporated businesses in common control. For example, in a group of five companies, all of the AIA could be allocated to one company or it could be split between all or any of the five, as the group might find most convenient.

19. At Budget 2010 the Government announced that the maximum amount of the AIA was to be increased from £50,000 to £100,000 for expenditure incurred on or after 1 April 2010 (CT) or 6 April 2010 (income tax), in order to provide further support for business investment. It also announced that a targeted anti-avoidance rule (TAAR) was to be introduced to accompany the AIA increase. This TAAR (amending provisions in Chapter 4 of Part 4 of the Income Tax Act 2007) comprises section 25 in Finance Bill 2010, for which there is a separate explanatory note.