FULL SPECTRUM
ACCOUNTANCY & TAX

Capital Gains Tax & Capital Allowances

There have been two major changes in tax policy which will have a significant impact on industries that are heavily reliant on capital assets, such as farming.

The changes are to come into force from 6 April 2008 for individuals and partnerships (and 1 April 2008 for companies with regards to capital allowances changes only). Until they are actually made law there is always a risk that details may be changed, though this is unlikely since the budget has confirmed matters.

Capital Gains Tax

The government has now committed itself to introducing a flat rate for capital gains tax of 18% for the next tax year and political spin implies this is a tax drop. The government have been forced to make a concession in relation to business assets following the removal of business asset taper relief. It has now been agreed that there will be a £1million life time allowance, which will still be taxed at 10%, on the gains from the disposal of all or part of a business, gains on the disposals of assets following cessation of a business and gains by certain individuals who were involved in running the business.

At present it is clear from the draft legislation "Entrepreneurs' Relief" will not apply to the disposal of excess business assets unlike the current business asset taper relief system. The lifetime limit is also the lifetime of the tax payer from the commencement of the new rules – not past transactions.

Under the current regime capital gains are taxed as the top slice of income for the tax year in which they arise and so could be taxed at 10%, 20% or 40%. With maximum business taper relief this equates to an effective tax rate of 2.5%, 5% and 10% respectively. Without business asset taper relief but with maximum non business taper relief these rates are 6%, 12% and 24%. Therefore the introduction of a flat rate of capital gains tax at 18% will only help those who are disposing of non business assets and whose gains are taxed at higher rates.

Under the current rules when an asset that was held on or before 31 March 1982 is disposed of (assuming no election has been made) the capital gain is calculated twice – once with the actual cost of the asset and once with the March 1982 market value of the asset. The tax payer can then chose the calculation that gives the lower capital gain. The new rules will make it compulsory to use the March 1982 value meaning tax relief could be lost.

Another factor to take into account is that indexation (the retail price index rise in the cost of an asset from March 1982 to April 1998) which inflates the cost of your asset for capital gains tax purposes will also be scrapped. Therefore, if you owned any assets subject to capital gains tax before April 1998 you will lose the indexation once the new rules come in. For assets held on or before 31 March 1982 that will be the equivalent of being taxed on an extra 104.7% of the original cost or March 1982 market value. This could mean that even if you benefit from the new lower tax rate you may still be worse off with the loss of indexation.

Do not be fooled by the political spin! You may be worse off if you have business assets, if you have assets owned before April 1998 or if you have a non business asset pregnant with gains and an average to low income.

There may still be time to put some plans into action in order to save some of the tax if, under these changes, you think you may be worse off, so please contact Evolve as soon as possible.

Capital Allowances

Last year's budget saw the removal of Agricultural Buildings Allowance and Industrial Buildings Allowance In addition there was talk of a revamp to capital allowances for cars and for plant and machinery generally.

The future proposals are the capital allowances on cars will be linked to CO_2 emissions from April 2009. The plans are that cars with emissions of 160g/km or less will have a 20% writing down allowance and all cars above that will have a 10% writing down allowance. This is a reduction for everyone since the current rate is 25%.

The recent budget has now implemented the proposed changes to general plant and machinery capital allowances as follows:

The general pool writing down allowance will be reduced to 20% per annum from 25%. There will be a new pool introduced for equipment integrated into buildings such as electrical systems and air-conditioning which will have a writing down allowance of 10%. Long life assets will have their writing down allowance increased to 10% from 6%.

The writing down allowance is the amount of tax relief a business receives each tax year on its pool of plant and machinery. Therefore, these changes are for the worse since generally the rate is reducing except for long life assets changes which are unlikely to be important to the majority of businesses.

Further bad news is that first year allowances for small and medium enterprises will be removed. . For small businesses this meant 50%, and for medium sized business 40%, of their plant and machinery expenditure was a tax deduction in the year of purchase. However, there is some good news in the form of the Annual Investment Allowance (AIA) which is available to all businesses.

The AIA will give 100% tax relief on the first £50,000 of capital expenditure on plant and machinery (excluding cars) each financial year. However, the proposed rules are not straightforward especially if your financial year is not in line with the tax year and it is important to seek professional advice to maximise the tax allowances.

The budget introduced two other new rules – that capital allowance pools of less than £1,000 can be written off and that a tax credit can be claimed instead of an increased loss where capital allowances are being claimed on energy efficient and water saving technologies.

Please contact us now if you need any advice or assistance in respect of this fact sheet, or if you would like us to deal with your tax affairs on your behalf.

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