Investment timing can save ££££s

Nigel Greenaway, general manager at JCB Finance, explains the significance of changes in UK tax rules and how the size and timing of any investment requires careful planning in order to maximise the potential tax relief that is now available.

Disinformation!

One of the surprises in the 5th December Autumn Statement was a tenfold increase in the Annual Investment Allowance (AIA) from £25,000 to £250,000 from 1st January 2013. The devil was in the detail and 15 pages of explanatory notes left many heads reeling! Unfortunately certain members of the accountancy profession do not seem to have come to terms with the new rules and have been giving out misleading information. The worst bit of disinformation is being reserved for the Plant Hire sector which is being informed by numerous accountants that equipment rental businesses are not eligible for the AIA.

Many accountants have been saying this since April 2008 when First Year Allowances (FYA) were replaced by the AIA. Before 2008 many accountants had been caught out by the HM Revenue & Customs (HMRC) disallowing FYA claims made on behalf of Plant Hirers because the business was supplying non-operated plant (while equipment supplied with an operator could claim the full FYA). This ruling was not carried over to the AIA so all businesses, including Plant Hire businesses, can claim the AIA - the only exceptions are Mixed Partnerships or Trusts (i.e. those in which a company is a member) - this has been verified by HMRC.

What is the AIA?

The AIA is designed to encourage investment in new or used equipment against taxable profits in the year in which the qualifying expenditure is made. The same rules apply to all businesses, large or small, incorporated or not, for expenditure incurred from 1st January 2013 and before 1st January 2015. The first £250,000 of expenditure is 100 percent allowable against tax, with any excess attracting the 18 percent annual Writing Down Allowance in the first year. This all sounds very good but what does it mean?

Imagine the following scenario: A plant hire business (a partnership of a father and his two sons) is rapidly approaching the end of its tax year and the accountant fears that a big income tax bill is looming. Even after claiming all available business expenses, a profit of £250,000 remains, which would attract the 40 percent income tax rate. The partnership's financial year matches the tax year. The accountant explains that, if the partnership invests £250,000 in replacement equipment, from the 6th April 2013 onwards, then the full £250,000 AIA will apply. Paying a 10 percent deposit (£25,000) and borrowing £225,000 over three years on a hire purchase agreement equates to a £100,000 outlay in the first year, followed by £75,000 in each of the subsequent years (net of interest charges).

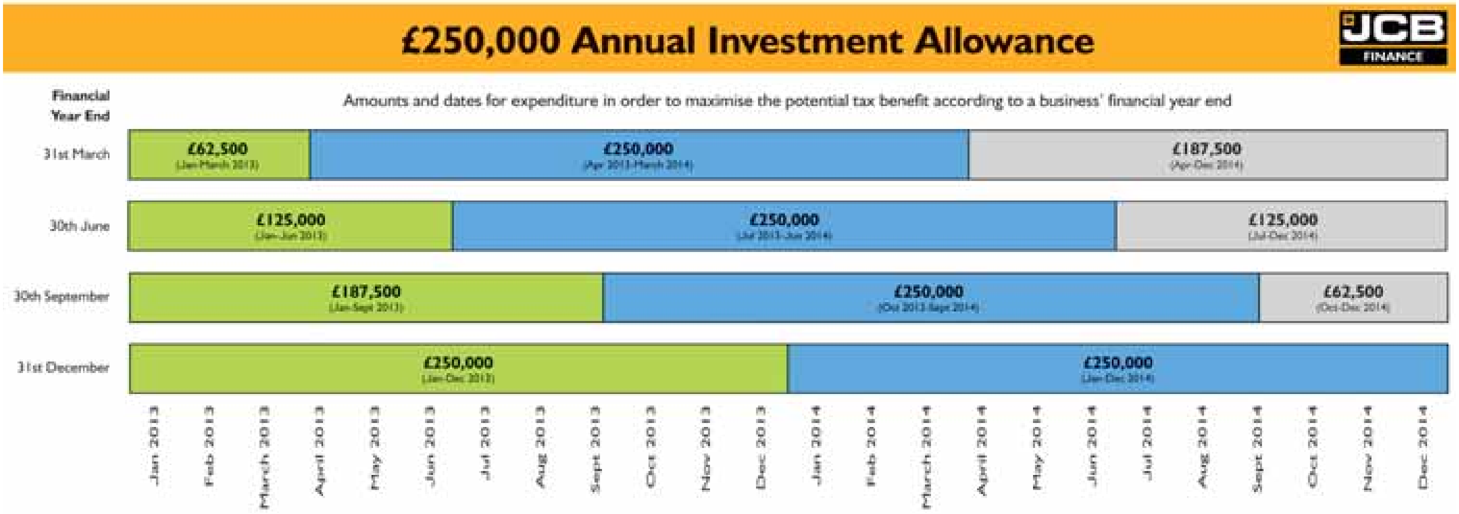
The £100,000 expenditure in the first year equals the £100,000 tax bill saved, so HM Revenue & Customs has effectively paid for the partnership's deposit and its first year's HP payments. Not only that, but the partnership has managed its cash flow in an exemplary fashion - claiming the maximum £250,000 AIA but with an outlay of only £100,000 in the same tax year. Paying £250,000 in cash on day one would only net the same tax benefit.

However, be warned because the above scenario is relatively simple to interpret. Different financial years that straddle the tax year and/or the 1st January 2013 will result in very complicated calculations that will result in a lesser AIA being granted in that financial year. In the example above, if the partnership, having not purchased any equipment in that financial year, decided to purchase plant on 1st January 2013 then it is conceivable that only 3/12 of the £250,000 could be claimed i.e. £62,500. After the new financial/tax year starts in 2013 another £250,000 will become available. The chart below illustrates this by showing four different financial year end companies and how vital it is to spend the right amount within the right periods in order to maximise the tax benefits.

Other factors being equal, if your business is contemplating purchasing any equipment in the near future, there are some strong tax-based and cash flow arguments to carefully plan your purchases before 1st January 2015, so that you can maximise on the available £500,000 tax relief.

Nigel Greenaway is general manager - marketing at JCB Finance and has more than 26 years' experience in the equipment finance industry.

Neither JCB Finance or the Vertikal Press are tax or financial advisors - always seek advice from your accountant or finance director, because every business is different. Businesses should not make investment decisions purely on a tax basis - there should be a compelling business case for the investment.



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