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Accountants & Financial Advisors

KEY GUIDE

Tax Allowances for Business Investment

Introduction

MAKING THE MOST OF YOUR INVESTMENT

Companies can qualify for a 100% first-year allowance, which effectively means full expensing for qualifying capital expenditure. There is also a 50% first-year allowance for special rate pool expenditure.

For unincorporated businesses, the high annual investment allowance limit of £1,000,000 for plant and machinery means that in most cases there is also full expensing of capital expenditure.

Where such generous reliefs are not available, it is important that you benefit from any other available tax relief for capital expenditure.

The October 2024 Budget confirmed that both the 100% first-year allowance for companies and the annual investment allowance are to be retained for the foreseeable future.

Capital allowances are, however, no longer relevant for many sole traders and partnerships because the cash basis is now the default method for calculating trading profit.

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This publication is for general information and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. This publication represents our understanding of law and HM Revenue & Customs practice as at 5 April 2025.

The main types of capital allowances

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You cannot deduct capital expenditure or depreciation when calculating your taxable profits. Instead, you can claim capital allowances if you are in business as an individual, a partnership, a company or as a trustee of a trust. Allowances may also be available if you let property. The most important allowances are those for plant and machinery, but allowances are also available for:

- commercial property;
- research and development expenditure;
- patent rights and know-how; and
- mineral extraction, cemeteries and crematoria, and dredging.

Allowances are normally given as a deduction in calculating your trading profits or the profits of a property letting business.

CASH BASIS

The cash basis is now the default method for calculating trading profit for the self-employed and most partnerships.

Capital allowances are generally not relevant if you use the cash basis to calculate your trading profit. Expenditure on business assets, such as machinery, computers and vans, is simply deducted as an expense, although capital allowances may still be relevant when it comes to cars.

A business can, however, opt out of the cash basis and use the traditional accruals basis instead. In this case, capital allowances are relevant. The cash basis is not suitable for some businesses, especially larger ones. The accruals basis is a more accurate reflection of a period's trading profit, and banks and other financial institutions may insist on this basis being used.

COMPANY SPECIFIC ALLOWANCES

Companies can benefit from enhanced capital allowances when they purchase plant and machinery:

- For expenditure that would fall into the main pool, there is a 100% first-year allowance. This effectively means qualifying capital expenditure is expensed as if it was revenue expenditure.
- For expenditure that would fall into the special rate pool, there is a 50% first-year allowance.

These enhanced capital allowances are not available to sole traders or partnerships.

Only expenditure on new plant and machinery qualifies, not expenditure on second-hand or used assets. Cars do not qualify.

Complexity

The availability of the enhanced allowances for companies has made planning for capital allowances somewhat more complex:

- For expenditure falling into the main pool, the 100% first-year allowance is unlimited – there is no £1,000,000 annual expenditure limit as there is for the annual investment allowance; this benefits larger companies with a high level of capital expenditure. However, the first-year allowance does not cover expenditure on second-hand assets, and the treatment of disposal proceeds will generally be more favourable where the annual investment allowance has been claimed compared to when the 100% first-year allowance has been claimed.
- For expenditure falling into the special rate pool, the

100% annual investment allowance should be claimed in preference to the 50% first-year allowance.

- If enhanced allowances are claimed, special disposal rules apply when the asset is sold. If the 100% first-year allowance has been claimed, disposal proceeds are brought in as a balancing charge (rather than deducted from the main pool). If the 50% first-year allowance has been claimed, 50% of the disposal proceeds are deducted from the special rate pool, with the other 50% brought in as a balancing charge.

Given that enhanced allowances are only relevant for companies, any further interaction with the other plant and machinery capital allowances is not covered in this guide.

100% RELIEF FOR PLANT AND MACHINERY

Your business can qualify for 100% tax relief in the year of purchase on the first £1,000,000 of expenditure on most types of plant and machinery by claiming the annual investment allowance (AIA). This means that there is no immediate difference between capital and revenue expenditure.

- The AIA is not available for expenditure on cars. Cars are defined as vehicles suitable for private use and not built for transporting goods. Therefore, the AIA is available for expenditure on lorries, vans and trucks and also motorcycles. Double cab pick-ups are classified as cars.

- Companies that are part of a group are entitled to only one AIA between them, but it can be divided as they wish. The same restriction applies if you have two related businesses that are run from the same premises.

Planning point

It is generally beneficial to incur expenditure qualifying for capital allowances just before, rather than just after, your accounting period end. You will then benefit from tax relief on the expenditure one year earlier.

First-year allowances

100% relief is also given where a first-year allowance is available. This is a separate allowance for expenditure on:

- new zero-emission cars (set to end on 31 March 2026 for companies or 5 April 2026 for unincorporated businesses);

- charge-point equipment for electric vehicles (set to end on 31 March 2026 for companies or 5 April 2026 for unincorporated businesses);

- plant and machinery expenditure incurred within certain designated enterprise zones (those where there is a strong focus on manufacturing) and also designated tax sites in freeports (for expenditure incurred from when the tax site is designated until 30 September 2031) and special tax sites in investment zones (the first investment zones became fully operational from spring 2024 – with tax incentives available for a ten-year period).

POOLED EXPENDITURE

Any expenditure over your AIA limit, or not qualifying for a first-year allowance, is 'pooled' into one of two pools. A writing-down allowance (WDA) is given every year on the balance of unrelieved expenditure in each pool. Which pool expenditure goes into depends on the type of asset.

When you sell a pooled asset, or an asset on which you have claimed AIA or a first-year allowance, the proceeds are deducted from the relevant pool balance before calculating the WDA. If the proceeds are greater than the pool balance, the excess – called a balancing charge – will be added to your profits.

A pool balance of £1,000 or less can be written off in full.

There are two rates of WDA:

- Assets in the main pool qualify for WDA at 18%. Cars with CO_2 emissions between 1g/km and 50g/km are included in this pool.

- The WDA is 6% for assets in the special rate pool. This pool consists of expenditure on integral features of a building,

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thermal insulation, long-life assets (those with a useful economic life of 25 years or more), and cars with CO_2 emissions above 50g/km.

EXAMPLE
Pooling

Oak Ltd bought second-hand machinery costing £1,270,000 during the year ending 31 March 2026. It can claim AIA on £1,000,000 of the expenditure (the 100% first-year allowance is not available for second-hand assets) and the other £270,000 will be added into the main pool. The WDA is £48,600 (£270,000 at 18%), with the remaining balance of £221,400 being carried forward to the year ended 31 March 2027, where a further WDA of 18% can be claimed on this brought forward figure.

As far as the main and special rate pools are concerned, a balancing allowance can only arise in the year that the business ceases. In the final year of trading, sale proceeds are deducted from the pool balance (no WDA or AIA is given). If sale proceeds are less than the balance then there will be a balancing allowance, and if the proceeds are greater there will be a balancing charge.

Planning point

The 100% first-year allowance is only available if a zero-emission car is bought new. The extra tax saving from having the 100% allowance could mean that it is beneficial overall to buy new rather than second-hand.

EXPENDITURE THAT IS NOT POOLED

Some expenditure is not pooled. This is mainly expenditure on short-life assets and on assets which you use partly for private purposes.

Short-life assets are those items that depreciate rapidly, such as computers, where you can make an election allowing you to claim faster allowances. An asset has a short life if it is not expected to last more than eight years after the end of the period in which it is bought. Electing for short-life assets treatment is only worthwhile if the expenditure does not qualify for AIA, i.e. because you have already exhausted your AIA limit for the current period.

Assets used partly for private purposes will have allowances restricted in accordance with the proportion of non-business use. This will include your car if you are in business as a sole trader or partner – but it does not include cars available for the private use of employees, because such cars are pooled.

EXAMPLE
Private use of an asset

Clare is in business as a sole trader. Her car (CO_2 emissions are 45g/km) cost £15,000, with 25% of the mileage being for private purposes. The WDA is restricted to 75% of the normal rate, so in the year of purchase Clare is entitled to a WDA of £2,025 (£15,000 at 18% x 75%).

A balancing charge or allowance (where sale proceeds are less than the unrelieved expenditure) will arise when a non-pooled item is sold.

Planning point

If you personally retain assets after cessation, they will be treated as sold at their open market value – increasing the amount of tax that you will have to pay for the final year of trading. Without any compensating sale proceeds, you will need to plan for this tax cost.

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LONG AND SHORT ACCOUNTING PERIODS

If your accounting period is less than 12 months, the amount of AIA and rate of WDA are reduced accordingly. So, for a four-month period the AIA is £333,333 (£1,000,000 x 4/12) and the rates of WDA are restricted by 4/12.

For individuals and partnerships, the same principle normally applies to periods longer than 12 months. For a 15-month accounting period the AIA would be increased by 15/12 and the rates of WDA are increased by 15/12.

However, first-year allowances are always given in full, regardless of the length of the accounting period.

A company cannot have an accounting period of longer than 12 months – such a period must be split into two. So, for a 15-month period, there will be a 12-month period with the normal AIA and rates of WDA, and a three-month period with reduced allowances. This treatment also applies if a sole trader or partnership has an accounting period longer than 18 months.

PARTNERSHIPS

Capital allowances must be claimed by the partnership collectively in the partnership tax return, not by the partners in their individual returns. Partners may often own business assets individually, especially cars, but capital allowances must be claimed in the partnership return. This means that a partner with an expensive car effectively shares some of their allowance with other partners who may have less expensive cars.

THE VALUE TO USE

With an outright purchase, you can claim capital allowances based on how much the item cost you, including any costs directly related to the acquisition. However, you cannot claim for interest or finance costs as these will be deducted as a normal business expense. The same principle applies if you buy an asset on hire purchase or by an alternative finance method – you can only claim capital allowances on the cost of the item itself, not the interest or other charges.

If you are VAT registered, you claim capital allowances on the net of VAT cost of the asset. However, if you are not VAT registered you will claim capital allowances on the total price paid, including the VAT element. The same principle applies if you are VAT registered but cannot reclaim all of the VAT – any irrecoverable VAT is included in the figure on which you can claim capital allowances. VAT is irrecoverable where cars are not used 100% for business purposes, and also where you make exempt supplies.

If you receive a business asset by way of a gift, then you can claim capital allowances based on the asset's market value when you start using the asset in your business.

When an asset is sold, the proceeds figure to be brought in is restricted to the original cost should you sell an asset for more than you paid for it. Proceeds will be net of VAT if you are VAT registered.

EXAMPLE
VAT and business use

Martha, who is registered for VAT, purchased a car on hire purchase. The cost of the car was £15,000, including VAT of £2,500, and the total price to be paid under the hire purchase agreement is £17,600. Unless the car is used 100% for business use, capital allowances will be based on the VAT inclusive cost of £15,000.

Planning point

Don't forget, when you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business.

WHEN IS EXPENDITURE INCURRED?

Expenditure is normally treated as incurred on the date when your obligation to pay becomes unconditional. However, there is an exception to this general rule. If you do not have to pay within four months, expenditure is not treated as incurred until the payment date.

When you first start to trade, you can claim capital allowances for any assets previously owned but now used by your business. The expenditure is treated as incurred on the date you start to trade, and assets will be brought in at their market value on that date.

Restricting capital allowance claims

A very useful feature of capital allowances is that claims can be restricted to meet your personal circumstances.

EXAMPLE
Restricting a claim to capital allowances

If your trading profit before capital allowances for 2025/26 will be £16,000, and the maximum capital allowances claim is £10,000, then you might claim just £3,430. The resulting profit of £12,570 would then exactly be covered by your personal allowance of £12,570. This is also the threshold up to which no national insurance contributions are payable.

PROBLEMS WITH BUILDINGS

You cannot generally claim plant and machinery allowances in respect of an asset which is part of your premises or the setting in which you carry on the business, such as floor tiles.

The distinction between 'plant' and 'setting' can be a fine one, although certain integral features of a building qualify for allowances regardless of the distinction – for example, electrical, water and heating systems, lifts and escalators.

Common items that usually qualify as plant or machinery include computers, office and shop furniture, machinery, tools and vehicles.

Second-hand buildings

Establishing the amount of expenditure that qualifies as plant and machinery can be difficult if you purchase a building, especially if the building is purchased second-hand. With a second-hand building, it is generally necessary for you and the seller to make a joint election regarding the value to be placed on the integral features. Also, no allowances will be available unless the seller has pooled the expenditure, even where the seller has never claimed any capital allowances.

Planning point

If purchasing a second-hand building, the amount of expenditure which will qualify as plant and machinery, and whether the structures and buildings allowance will be available, should be established early on in the negotiations. It will be relevant when deciding on the price to pay, and could be the deciding factor if there is a choice of buildings.

STRUCTURES AND BUILDINGS

There was previously no relief for the cost of buildings unless expenditure qualified as plant and machinery. However, if you buy commercial property where the construction contract was signed on or after 29 October 2018, the structures and buildings allowance (SBA) can now be claimed. Relief is currently given at an annual flat rate of 3% over a 33⅓-year period (33 years and four months), with a separate SBA given for each structure or building qualifying for relief.

- Offices, retail and wholesale premises, walls, bridges, tunnels, factories and warehouses can all qualify for relief.
- The cost of land, legal fees, stamp duty and the cost of obtaining planning permission are excluded, as is any part of a building used as a dwelling house. Work spaces within domestic settings, such as home offices, also do not qualify for relief. Expenditure that qualifies as plant and machinery cannot also qualify for the SBA.
- If you buy an unused building that has been constructed by a developer, then the qualifying expenditure will be the price that you pay less the value of the land.
- It doesn't matter if the property is situated overseas as long as your business is within the charge to UK tax.
- Relief is also available for the cost of converting or renovating a property. The expenditure qualifies for its own separate 3% write-off over the next 33⅓ years.
- The allowance will cease to be available if a structure or building is demolished.
- The rate of SBA is 10% for qualifying properties situated in tax sites in English Freeports where the property is brought into use by 30 September 2031 (30 September 2034 for equivalent sites in Scotland and Wales). The same 10% rate is available for qualifying properties situated in special tax sites in investment zones.

EXAMPLE
Structures and buildings allowance

Elm Ltd bought an office building (not situated in a freeport) from a developer on 1 April 2025 for £800,000, with £350,000 of this being the value of the land. The building was immediately brought into use for Elm Ltd's trade. For the year ended 31 March 2026, Elm Ltd can claim an SBA of £13,500 ((£800,000 – £350,000) at 3%). The claim will continue for the next 32⅓ years unless the office building is sold before then.

LET PROPERTY

Capital allowances are not available for assets such as tables, beds, carpets, cookers and washing machines used in a dwelling.

However, replacement furniture relief allows you to claim a 100% deduction for the cost of replacing furniture, furnishings, appliances and kitchenware provided for a tenant's use. No relief is given for the initial cost of furnishing a property or for any part of the cost representing an improvement. The amount of relief is reduced by any proceeds from selling the old asset which has been replaced.

EXAMPLE
Replacement furniture relief

Joe purchased an unfurnished house on 6 April 2025 and will let it out throughout 2025/26. During April 2025, he furnished the house with a cooker costing £460, a washing machine costing £370 and floor coverings costing £2,400.

The cooker was sold in November 2025 for £90 and replaced with a similar model costing £500. The washing machine was scrapped, with nil proceeds, in December 2025. It was replaced by a washer-dryer costing £660, although the cost of a similar washing machine would have been £380.

No relief is available for the initial cost of the cooker, washing machine and floor coverings. Relief for the replacement cooker is £410 (£500 – £90). Relief for the washer-dryer is restricted to £380, since no relief is given for that part of the cost that represents an improvement over the original washing machine.

Planning point

Make sure that you are claiming for the cost of replacement furniture and furnishing. A property does not need to be fully furnished for relief to be available.

RESEARCH AND DEVELOPMENT EXPENDITURE

If you incur capital expenditure on research and development (R&D) related to a trade you are carrying on (or for a trade you are about to carry on), the expenditure can qualify for a 100% allowance. It should be noted that:

- The cost of any land does not qualify.
- If you subsequently sell an asset on which relief has been given, the sale proceeds will be added to your trading profits.

There are separate R&D tax reliefs for revenue expenditure.

OTHER ALLOWANCES

Capital allowances for patent rights and know-how are given at 25% on the balance of unrelieved expenditure at the beginning of the year.

Mineral extraction allowances are given at 25% on certain expenditure on the acquisition of minerals or rights over them, and pre-trading exploration expenditure.

HOW WE CAN HELP

If you are in business or you let property, we can advise you about what capital allowances you can claim and how you might be able to maximise the allowances available, especially in regard to the 100% and 50% first-year allowances available to companies. We will also make sure you are kept abreast of future developments.

People who buy commercial property often do not appreciate the extent to which they can claim plant and machinery allowances for fixtures and equipment in the building. We can help you identify qualifying costs, and you may be entitled to the SBA.

We can also advise you on the tax implications of different methods of acquiring assets, for example outright purchase or leasing, and on the best timing of your purchase or disposal. You should speak to us at an early stage in your planning.

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