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The latest outlook for capital allowances

Capital allowances are important for any business, serving to improve cash flow, bring down investment costs, and lower the tax liability.

But drill into the detail, and the regime is complex, and changes taking effect this year only add to the complexity. We look at the latest position here, with a focus on the area that matters most to the majority of businesses: plant and machinery allowances.

Why capital allowances are important

Capital allowances allow businesses to set the cost of qualifying capital assets against taxable profits. In general terms, for a company paying Corporation Tax at 25%, capital allowances have the potential to create a tax saving of £2,500 on a qualifying spend of £10,000. Such allowances take the place of commercial depreciation, which is not allowed for tax.

Conditions to claim

Companies, partnerships and individuals can all claim capital allowances, provided that their profits are within the charge to UK tax.

There must be a qualifying activity – such as a trade, UK or overseas property business; and the expenditure must be qualifying expenditure on the provision of plant or machinery wholly or partly for the purposes of the qualifying activity. Normally, the person must own the asset as a result of incurring the expenditure. Assets acquired on hire purchase will usually be eligible for capital allowances, but do please talk to us about the detail of the rules, and similarly for assets acquired under leases.

Which assets are eligible?

Plant and machinery is not a term defined in legislation, but the category is a wide one, broadly encompassing all machinery and equipment used in a business. It includes, for example, tools - such as lathes, chainsaws or mowers; specialist machinery; computers, office furniture and equipment; integral features such as cold water systems, electrical systems, and heating systems; some fixtures and fittings; commercial vehicles like vans (but for cars, see below).

Which assets are excluded?

Intangible assets (apart from computer software), land, buildings and most structures are excluded. The biggest question marks over eligibility are often for assets incorporated into buildings, and specialised structures.

Special cases

Property businesses: Strictly, capital allowances are not available to residential landlords, and the position as regards tax relief can be complex. Please talk to us to discuss the reliefs, such as replacement of domestic items relief, which may be available. For both UK and overseas property businesses, expenditure on plant and machinery for use in a dwelling house does not qualify.

Businesses using cash basis accounting, rather than accruals basis cannot claim capital allowances. Instead, tax relief is generally given by deducting the cost as an expense.

Key allowances available

There are three main types of plant and machinery allowance: the Annual Investment Allowance (AIA); First-Year Allowances (FYAs); and Writing Down Allowances (WDAs).

Under these headings come a range of different rates of relief, different timescales for delivering relief, different eligibility conditions and different rules. Some allowances are available only to certain types of business, for example. In addition, the rules governing tax treatment on disposal can be different, too.

Which option? Broadly, where expenditure qualifies for more than one type of allowance,

it is a matter of choice which allowance is used. In many cases, the determining factor will be the speed at which tax relief is given. FYAs provide immediate, up-front, tax relief, whereas WDAs are slower, giving relief over a period of years.

Other tax reliefs: The Structures and Buildings Allowance, for the construction, renovation or conversion of non-residential structures or buildings; Research and Development Allowances; and allowances for qualifying expenditure in UK Freeports or Investment Zones are subjects in their own right. Please do contact us if they are of interest to you.

Tip: Different treatment for cars

There are specific rules for expenditure on cars, with treatment depending on when the car was acquired, and its CO_2 emissions. Cars are not eligible for the AIA, Full Expensing or the new 40% FYA. However, there is a 100% FYA for zero emission cars and EV charging points. This has been extended to 31 March 2027 for Corporation Tax, and 5 April 2027 for Income Tax purposes, creating a considerable tax incentive to invest in electric technology.

Capital allowances compared

AIA: key facts

- Who can use: unincorporated businesses and companies.
- Who can't: partnerships with a corporate member.
- Rate of relief: 100% tax relief for business expenditure on plant and machinery.
- Upper limit: relief capped at £1 million per year.
- £1 million limit must be shared between groups of companies and in some other cases.
- Provides up-front access to tax relief.
- Must be claimed in year in which expenditure is incurred: note that this has a specific definition for tax purposes.
- Disposals deducted from balance of capital allowance pool, if available.
- Not available for cars - see below.
- Can be used to provide faster means of relief for special rate expenditure.

Tip: Where the AIA fits in

For many businesses, the AIA gives sufficient relief for all capital expenditure needs. Where capital spending is more than the AIA annual limit, however, WDAs give relief for the excess qualifying expenditure.

Full Expensing: key facts

- Who can use: companies and corporate members of partnerships only.
- Who can't: sole traders/partnerships.
- Rate of relief: 100% FYA for expenditure on most new and unused plant and machinery that would ordinarily qualify for main rate WDAs.
- Upper limit: none.

Special rate allowance: key facts

- Who can use: companies and corporate members of partnerships only.
- Who can't: sole traders/partnerships.
- Rate of relief: 50% FYA for expenditure on most new and unused plant and machinery that would ordinarily qualify for 6% special rate WDAs (not second-hand assets).
- Upper limit: none.
- Special rate WDAs are available for use on the remaining balance of expenditure.

Full Expensing and Special rate FYAs

- Give rapid access to tax relief.
- Must be claimed in year in which expenditure is incurred.
- Not available for cars, or assets acquired for leasing.
- Not available for second-hand assets. Assets must be new and unused.
- Only available for expenditure incurred on or after 1 April 2023.

Tip: Disposals

Special rules govern disposal of assets on which either of these FYAs have been claimed. These treat disposal proceeds as taxable income, and claw back relief. Please talk to us for more information.

WDAs

These give relief where expenditure has not been fully covered by the AIA, Full Expensing or other FYAs. They work by putting qualifying expenditure into capital allowance pools, and deducting a percentage of the remaining balance every year, on a reducing balance basis.

The default pool for most unrelieved expenditure is the main pool. Some assets (such as integral features, high emission cars and long-life assets) are assigned to the special rate pool. There can also be single asset pools. These are used, for example, for some short life assets; and in unincorporated businesses, where there are assets with private use.

Key facts

- From April 2026, main rate WDAs reduced to 14%, from 18% (see below).
- Special rate WDAs remain at 6%.
- On disposal, sale proceeds (or original cost if lower) are brought into the relevant pool. If proceeds are more than the value in the pool, the difference is treated as additional taxable profit for the period. This is technically referred to as a balancing charge.

Tip: Analysing expenditure

Analysis of all expenditure is particularly important in order to make optimal use of the capital allowances available, including the AIA and other FYAs.

Change from 2026

Two important developments take effect this year. The introduction of a new, more widely available 40% FYA for main rate plant and machinery; and the cut to the rate of main rate WDAs. The new FYA is obviously good news.

The lower rate for WDAs, on the other hand, is not such good news, and stands to impact some 650,000 businesses.

New FYA

- Intended to plug gap in existing capital allowances, and beneficial where the AIA or existing FYAs, such as Full Expensing, are unavailable or not the preferred route.
- Available for new main rate plant and machinery expenditure (not special rate expenditure) incurred on or after 1 January 2026.
- What's new: availability
  Unlike other FYAs (such as Full Expensing and the AIA), it is available to sole traders and partnerships (including partnerships with corporate members) as well as companies.
- What's new: assets eligible
  Can be used for assets used for leasing (unlike Full Expensing) as well as for main rate expenditure on new and unused plant and machinery. Overseas leasing is excluded.
- Second hand assets, and cars are excluded.
- Rate of relief: 40%, with remaining unrelieved expenditure available for pooling in following or later chargeable period.
- Upper limit: none.

Tip: HMRC guidance

HMRC has recently published guidance on the new FYA in its Capital Allowances Manual CA23195, which is available online. This gives details about provision of plant and machinery for leasing, in particular, with practical examples and guidance about what constitutes overseas leasing.

Reduction in rate of main rate WDAs

- WDAs for main rate expenditure fall from 18% to 14% per year from 1 April 2026 for Corporation Tax/6 April 2026 for Income Tax.
- Businesses with a chargeable period spanning 1/6 April use a hybrid rate. This is based on the proportion of the chargeable

period falling before the change date and the proportion falling after it.

- Means slower tax relief for businesses with pools of unrelieved historic main rate expenditure which was not covered by the AIA, super-deduction or Full Expensing; and those incurring main rate expenditure falling outside the scope of FYAs in future.

The reduction makes the timing difference between different routes to tax relief greater, and use of FYAs more advantageous.

Tip: Major capital project?

Businesses involved in major capital projects, may prefer to review expenditure on a rolling basis, with a view to claiming capital allowances when expenditure is incurred, rather than leaving this to the end of the project.

Impact of disposals

The tax treatment on disposal can vary depending on the type of capital allowances claimed. With Full Expensing, there is an immediate balancing charge on disposal. With the AIA, the disposal value is deducted from the balance of the capital allowances pool. With the new 40% FYA, it has recently been confirmed that normal disposal rules apply: there is no immediate balancing charge.

Making the best of your claim

Claims for capital allowances are made in the tax return, for both companies and unincorporated businesses. This is normally done to specific deadlines, usually two years after the end of the accounting period for companies. Sometimes it can be more beneficial to restrict a claim, or not to claim at all. This may be the case if there are losses, for example.

Recent HMRC guidance on common errors highlights the importance of good record keeping to support claims. Keeping a full, accurate list of assets, with documentation showing when assets were purchased, and brought into use in your business is the starting point. It is also important to record whether assets are new or second-hand.

Please do talk to us before any significant investment or disposal is made. Timing matters, and together we can work to ensure that your business gets the best out of the rules on capital allowances.

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