



## FALKLAND ISLANDS GOVERNMENT TAXATION OFFICE

### DEPRECIATION ALLOWANCES – INFORMATION FOR TAXPAYERS FROM THE

1<sup>ST</sup> OF JANUARY 2005

#### **Introduction**

Falkland Islands tax legislation does not allow tax relief for capital expenditure either as a direct deduction in business accounts or through depreciation costs. However there are special tax allowances available for certain categories of capital expense. This leaflet explains what can be claimed, how and when.

Tax Allowances for expenditure on capital items are called Capital Allowances, or Depreciation Allowances. The term 'Depreciation Allowances' is generally used throughout the Falkland Islands tax legislation and it is therefore used in this leaflet.

#### **What capital expenses can I claim for?**

Allowances can only be claimed in relation to business enterprises operated either as sole traders, partnerships or companies.

Depreciation allowances are available on the following capital expenses:

- Vehicles
- Ships
- Aircraft
- Plant and machinery
- Office equipment
- Buildings
- Fencing

Assets bought on hire purchase qualify for a depreciation allowance based on the original cost. Any associated interest charges would be claimed separately as business expense.

Some of these categories are quite wide – if you cannot be certain that an item will qualify for depreciation allowances by reading this leaflet then you should raise the question with the Taxation Office.

Items must be used, or be intended for use, in the business in order to qualify for an allowance.

#### **What capital expenses do not qualify for allowances?**

Depreciation allowances cannot be claimed for capital expenses of a private or domestic nature.

Allowances cannot be claimed for land or livestock.

In cases where a building qualifies for depreciation allowances and land is included in the original cost, then it is necessary to separate the two in order that the cost of the land is excluded.

Revenue expenditure, for example expenditure for the repair and maintenance of a vehicle or building, does not qualify for depreciation allowances (it would, however, possibly qualify as a tax deductible business expense).

If a fixed asset has a dual purpose, for example a vehicle is used partly for private use and partly for business purposes, then the depreciation allowance can be apportioned to allow relief on the business element. For further information on the apportionment of depreciation allowances you are advised to consult your tax advisor or the Taxation Office.

### How do I make a claim for depreciation allowances?

When you submit your accounts to the Taxation Office you should also submit a list showing what depreciation allowances you wish to claim. The information that the Taxation Office will require is as follows:

- a) Description of the fixed asset
- b) Date of purchase
- c) Cost
- d) Whether or not there is any private use, and if so how much.
- e) How much depreciation allowance you wish to claim.

Please note that e) above may be complicated by the fact that the certain categories of depreciation allow for different rates and methods but it is up to you to decide how much you wish to claim.

Businesses should submit a **tax computation** with their accounts. A tax computation is a useful way to show how depreciation allowances are reconciled with the profits shown on the accounts and the taxable profits (adjusted profits shown on your tax return). If you are in any doubt as to whether or not we will understand how you want depreciation allowances, or any other adjustments, calculated, then it is essential to submit a tax computation.

### What are the depreciation allowances rates?

The amounts that may be claimed each year are

Asset	Allowance per annum	Method of Depreciation	See Note
Plant, Machinery & Vehicles	up to 40%	Reducing Balance	1
Ships	up to 20%	Straight Line	
Buildings	up to 10%	Straight Line	2
Other Buildings	None		3

Note 1 The 'Plant and Machinery' category includes aircraft, fencing, office equipment, tools and equipment, etc. Pooling of assets can be used for plant, machinery and vehicles.

Note 2 "Buildings" includes industrial, commercial, agricultural, mining, fishing and hotel buildings.

Note 3 "Other buildings" includes let residential accommodation. Please note that there are special rules for depreciation allowances relating to residential

accommodation – please consult the Taxation Office if you require further information.

### **How is the depreciation allowance calculated?**

The depreciation allowance is calculated by reference to the original cost or value. If the cost of a vehicle is £6000 the maximum allowance will be 40% of £6000 which is £2400. If it were decided that only 25% should be claimed in the first year then the allowance for year 1 would be £1500.

The reducing-balance method is then used to calculate the opening balance for year 2:  
 $£6000 - £2400 = \text{year 2 balance } £3600$ . The year 2 allowance would then be calculated at 40% of £3600 = £1440. The year 3 opening balance (known as the 'written down value') would then be £2160 ..... and so on.....

The straight-line method is then used to calculate the opening balance of a Building at a cost of £10000:

$£10000 - £1000 = \text{year 2 balance } £9000$ . The year 2 allowance would then be calculated at 10% of £10000 - £1000yr1 - £1000yr2. The year 3 opening balance (known as the 'written down value') would then be £8000..... and so on.....

**I may wish to calculate different depreciation allowances for my accounts to show the wear and tear on an asset over a set number of years. What would happen if I wanted to claim 40% in the first year on a vehicle that cost me £6000, in order to reduce my tax bill for that year, but at the same time I wanted to show the value of the vehicle in my balance sheet as reducing to 0 over six years?**

You can do just that. Show the accounting depreciation rate (£1000 per annum) in your accounts as a wear and tear allowance, and adjust the fixed assets in the balance sheet accordingly. When you submit your accounts to the Taxation Office you should enclose a tax computation to show how the accounting depreciation is added to the net profits, and the 40% tax depreciation (£2400) is subtracted.

### **What happens if I sell an asset that depreciation allowances have been claimed for?**

If you sell an asset upon which depreciation has been claimed then a **balancing charge** may be incurred. A balancing charge is a claw-back of depreciation allowances. The following is an example of the calculation of a balancing charge:

In the example shown earlier in this leaflet a vehicle is purchased for £6000 and depreciation is claimed at 40% on a diminishing value basis over three years. In year three the written down value = £2160 less depreciation allowance @ 40% (£864) = £1296. The vehicle is then sold for £3000. Because the vehicle is sold for an amount in excess of the written down value a balancing charge must be calculated (if it was sold for less than the written down value, say £1200, then no balancing charge would be imposed – see *balancing deduction* below).

The balancing charge must be the lesser of the difference between the sale proceeds of the asset and its written down value ( $£3000 - £1296 = £1704$ ) and the total amount of depreciation claimed during the ownership by the business of the vehicle (the total depreciation claimed =  $£6000 - £1296 = £4704$ ). The result of this comparison is that the difference between the sale proceeds and the written down value is the smaller amount.

When you submit your accounts to the Taxation Office you should therefore include a computation showing £1704 added to the taxable income arising to the business.

If the vehicle was sold for less than the written down value then a **balancing deduction** would arise. Example: the vehicle is sold for £1200. The taxable income of the business would be reduced by £96 (£1296 written down value minus £1200 sale price). Please note that special rules exist to deter tax advantages being gained by dealings with connected parties.

### **Do I have to claim depreciation allowances?**

For tax accounting purposes you do not have to claim depreciation allowances.

If you choose not to claim depreciation allowances in a given year then you will have a higher written down value to carry forward to the next year. It should be noted, however, that if allowances relating to a particular asset are carried forward continually and remain unclaimed until the asset is scrapped, then the benefit of the allowance would be lost.

### **What happens if I want to bring something, say a vehicle, into my business after I have been using it for purely private purposes for several years?**

You can bring the vehicle into your business, but not at the original cost. The opening balance for depreciation purposes will be *the value of the vehicle at the time that it is brought into the business*.

### **What will happen if I wish to remove that same vehicle from the business after several more years?**

The value of the vehicle will be calculated at the time that it is removed from the business, and this will be compared to the written down value at the time of the withdrawal. A balancing charge or balancing deduction will then be calculated to compensate for any advantages or disadvantages that may have arisen.

### **If I obtain a grant for part of the cost of some capital equipment, how will I adjust my tax depreciation?**

This is best answered with a simple example: A farmer buys a tractor worth £10000. He is given a grant of £3000 to assist with the purchase.

The amount received in the way of a grant is not declared as income, and the expense of the tractor is not declared as expenditure on the Profit and Loss Account. Therefore the cost of the tractor is reduced by the amount of the grant (£10000 - £3000) and the opening balance for depreciation allowances = £7000.

### **What is 'Pooling of Assets'?**

Pooling of assets is only allowable for Plant, Machinery and Vehicles. This is where all assets are added together and the total is taken as the balance for the category. The total is then depreciated at up to 40% if you choose to do so. This cuts down on administration and eliminates confusion over values on the calculation of balancing allowances and charges when individual assets are sold.