FALKLAND ISLANDS GOVERNMENT TAXATION OFFICE

Depreciation Allowances – from 1 January 2016

Introduction

Falkland Islands (FI) taxes legislation does not allow 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.

Depreciation allowances are not allowable on residential properties that are outside FI, however a wear and tear deduction of 10% of gross income is allowable.

Tax allowances for expenditure on capital items are called Capital Allowances, or Depreciation Allowances. The term 'Depreciation Allowances' is generally used throughout FI taxes legislation and 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.

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

Some of the categories are quite wide – if you cannot be certain that an item will qualify for depreciation allowances by reading this leaflet, you should raise the question with our 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 land, livestock and capital expenses of a private or domestic nature.

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, qualify as a tax deductible business expense subject to restriction based on the apportionment of private : business use of the asset).

If a fixed asset has a dual purpose, for example a vehicle is used partly for private use and partly for business purposes, 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 our office.

How do I make a claim for depreciation allowances?

When you submit your accounts to our office you should also submit a list showing what depreciation allowances you wish to claim. The information we 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 categories of depreciation allow for different rates and methods but it is up to you to decide how much you wish to claim, subject to the business % maximum allowed for the particular asset.

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 allowance rates?

Below is a summary of the general allowances, in addition there are some specifically for FI rural businesses.

Asset	Maximum allowance per annum	Depreciation Method	See Note
Plant, Machinery & Vehicles	40%	Reducing Balance	1
Ships	20%	Straight Line	
Buildings (not in camp)	10%	Straight Line	2
Buildings (in camp, excluding farmhouses)	25%	Straight Line	2
Farmhouses	10%	Straight Line	
Other Buildings	None		3
Car park or hard standing	2%	Straight line	
Road	2%	Straight line	4

Note 1 ‘Plant and Machinery’ includes aircraft, fencing, office equipment, tools and equipment, etc. Pooling of assets can be used for this category.

Note 2 ‘Buildings’ includes industrial, commercial, agricultural, mining, fishing and hotel buildings. Depreciation allowance only allowable for those that qualify.

Note 3 ‘Other buildings’ includes residential accommodation (please note there are special rules relating to such buildings – consult our office if in doubt).

Note 4 Expenditure incurred in constructing the road is limited to £100,000 per km of road.

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 £6,000 the maximum allowance will be 40% of £6,000 which is £2,400. If it were decided that only 25% should be claimed in the first year then the allowance for year 1 would be £1,500.

The reducing-balance method is then used to calculate the opening balance for year 2:
£6,000 - £2,400 = year 2 balance £3,600. Year 2 allowance would be calculated at 40% of £3,600 = £1,440. Year 3 opening balance, known as the 'Written Down Value' (WDV), would be £2,160 and so on.

The straight-line method is used to calculate the opening balance of a Building at a cost of £10,000:
£10,000 - £1,000 = year 2 balance £9,000. Year 2 allowance is still 10% of £10,000 so the year 3 opening balance (known as WDV) would be £8,000 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 £6,000, 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 (£1,000 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 our office you should enclose a tax computation to show the accounting depreciation added to the net profit, and the 40% tax depreciation (£2,400) 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 for more than WDV at the start of that accounting period then a **balancing charge** will be incurred. A balancing charge is a claw-back of depreciation allowances. The following is an example of the calculation of a balancing charge:

A vehicle is purchased for £6,000 and depreciation is claimed at 40% on a reducing balance basis over 3 years. In year 3 WDV equals £2,160 less the depreciation allowance @ 40% (£864) = £1,296. The vehicle is then sold for £3,000. Because the vehicle is sold for an amount in excess of WDV, a balancing charge must be calculated (if it was sold for less than WDV, say £1,200, then no balancing charge would be imposed – see *balancing allowance* below).

The balancing charge must be the lesser of the difference between the sale proceeds of the asset and its WDV (£3,000 - £1,296 = £1,704) and the total amount of depreciation claimed during the ownership by the business of the vehicle (total depreciation claimed = £6,000 - £1,296 = £4,704). The result of this comparison is that the difference between the sale proceeds and WDV is the smaller amount. When you submit your accounts to our office you should include a computation showing £1,704 added to the taxable income arising to the business.

If the vehicle was sold for less than WDV at the start of the accounting period during which it was sold, then a **balancing allowance** will arise. Example: vehicle is sold for £1,200. The taxable income of the business would be reduced by £96 (£1,296 WDV minus £1,200 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 purposes you do not have to claim all of the depreciation allowances available. If you choose not to claim the whole or part of the depreciation allowances in a given year then you will have a higher WDV to carry forward to the next year. However, it should be noted that if allowances relating to a particular asset are carried forward continually and remain unclaimed until the asset is scrapped, 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 at the time it is removed from the business will be compared to WDV at the time of the withdrawal. A balancing charge or balancing allowance will then arise to compensate for any advantages or disadvantages that may have arisen in the depreciation claimed.

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

This is best answered with a simple example: A farmer buys a tractor worth £10,000. He is given a grant of £3,000 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 (£10,000 - £3,000) and the opening balance for depreciation allowances equals £7,000.

What is 'Pooling of Assets'?

Pooling of assets is only allowable for the 'Plant, Machinery and Vehicles' category. 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 reduces administration and eliminates confusion over values on the calculation of balancing allowances and charges when individual assets are sold.

<u>Note</u>: This is a brief summary of the law and practice at the time of writing. It is not binding in law and does not affect your rights of appeal. You should bear in mind that the information offers general guidance on how the rules apply, but whether the guidance is appropriate in a particular case will depend on all of the facts. You should therefore consult the Taxation Office on how the rules apply in your own case.

Contact details

If you need more information on the tax treatment of depreciation allowances, you can contact our office. Alternatively you may wish to seek professional advice e.g. from a lawyer or accountant.

Public opening hours	**Mon to Fri, 9am – 12noon** (afternoon appointments by prior arrangement)

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