Borrowing - making it work for your business

The majority of businesses will need to take out a loan at some stage. Borrowing can help pay for new equipment or plant; or it can fund the expansion of development of a business.

As with all credit, there is, of course, a cost to borrowing: the interest charged on the capital lent.

There are, however, two ways of reducing the cost of borrowing.

One is to shop around for the best interest rate deals offered by lenders. The best way to approach a new lender is to have a detailed and up to date business plan.

The other is to take advantage of some of the tax breaks available on business borrowings.

The tax reliefs will not offset the entire cost of lending but can help to reduce a portion of the charges made by a lender.

Leasing

Many firms opt to rent or lease assets such as plant or machinery.

One of the attractions of renting or leasing is that the cost is deductible as a business expense, which can help lower the overall cost of the money invested.

Buying

Businesses that choose to buy new plant or equipment are also in a position to deduct a part of the cost of the purchase from their taxable profits.

Known as capital allowances, they cover a set percentage of the price of the asset. Smaller firms, though, are entitled to a higher percentage in the tax year in which the asset was purchased.

Capital allowances apply whether a business borrows the money to make an outright purchase or buys it on a hire purchase agreement. In the first case, the tax relief can be used to offset some of the cost of the borrowing.

Businesses can claim a 100 per cent investment allowance on the first £100,000 of allowable expenditure from 1 April 2010 for corporation tax purposes and from 6 April for income tax purposes.

However, firms need to be aware that the government has decided that, as part of its drive to simplify the tax system and to pay for reductions in corporation tax, the annual investment allowance comes down from £100,000 to £25,000 as from April 2012.

Loan interest payments and tax

Interest payments on a loan taken out to buy or hire a business asset is deductible from taxable profits because it is a business expense.

But remember that the asset in which the money is invested must be used for solely business purposes if the tax deduction is to apply.

The same rule covers the interest chargeable on overdrafts and business credit cards: the money must be used exclusively for business and not personal purposes.