Vehicle taxation

With the UK government targeting lower CO_2 emissions, this guide seeks to explore how tax legislation is being used to encourage businesses into acquiring more environmentally-friendly and fuel efficient vehicles. Some of the new legislation is already in place with the remainder coming into force over the next few years and this article will explain how the rule changes could affect you, your business and your employees.

CAPITAL ALLOWANCES AND LEASE CHARGES

The former Chancellor of the Exchequer, Alistair Darling, set the agenda to encourage businesses to own and use cars emitting a lower amount of CO_2 by linking the writing down allowance on hire purchase cars and the amount of disallowance on lease car charges to the CO_2 rating of the vehicle.

CAPITAL ALLOWANCES

Significant changes to the capital allowance treatment for cars were introduced from 1 April 2009 for companies (6 April 2009 for unincorporated businesses). The writing down allowance is the amount that can be claimed in a period as a deduction against business profits.

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Cars acquired since this date are now treated differently depending on their certified CO_2 emissions:

- Low emission cars (no more than 110 g/km): expenditure benefits from an allowance of 100% in year of acquisition until 31 March 2013
- Medium emission cars (over 110 g/km but no more than 160 g/km): expenditure goes into the general capital allowances pool with a writing down allowance of 20%
- High emission cars (> 160 g/km): expenditure goes into the special rate pool with a writing down allowance of 10%

One of the major impacts of the new rules for cars purchased by companies under the new system is the loss of the balancing allowance. Generally, most businesses that own cars replace them every three or four years. Under the old rules, whilst the writing down allowance is restricted to £3,000 pa for expensive cars (over £12,000), when the car is disposed of there is usually a balancing allowance which ensures that all of the net cost (purchase price minus sale proceeds) benefits from tax relief.

However under the new rules, cars that do not meet the low emission car criteria listed above will either be allocated the 20% pool or the 10% pool and in both cases there will be no balancing allowance on disposal. The time delay in obtaining full tax relief may be significant.

For example, a company acquired a car for £50,000, with CO_2 emissions of 190 g/km. It is likely to sell the car after four years by which time the proceeds will be £20,000. If the car was bought in March 2009, it would receive a capped writing down allowance of £3,000 pa for three years, followed by a balancing allowance in year four of £21,000 on sale. The total cost of £30,000 (purchase price less sale proceeds) will have been relieved. If it was purchased in April 2009, it would receive slightly higher writing down allowances in the first three years of ownership, but with no balancing allowance on sale it will take approximately eight years to relieve the first £20,000 of that £30,000 cost to the business, and a further 20 years to relieve the next £10,000.

For unincorporated businesses, assets with private use are each given their own pool so that the relevant writing down allowance can be reduced for the element of non-business use. This will continue to be the case with cars under the new regime. The significance of this is that it keeps the asset out of the main pools and on disposal a balancing allowance is still available. It is important to note that this would not apply to a car provided by the business to its employees.

LEASE CHARGES

Cars under leases taken out from April 2009 will be subject to the new 15% disallowance rule where CO_2 emissions exceed 160 g/km. Cars under existing leases will remain under the current regime until the lease comes to an end.

Under the old rules, the lease payments for a £50,000 car would have 38% of the payments disallowed. Under the new rules, there will be no disallowance if emissions are no more than 160g/km. Leasing may therefore be more attractive than it used to be.

In summary, the practical impact of the changes may make it more costly to provide some company cars. Employers may wish to review their car policies and possibly exclude vehicles with CO_2 emissions in excess of 160 g/km from their fleet. The new rules could also change the relative after tax costs of purchase or hire.

COMPANY CAR BENEFIT

The provision of a company car is normally considered a taxable benefit for an employee or a director. The company car benefit charge for a full year is obtained by multiplying the price of the car for tax purposes (in most cases, its list price plus accessories less capital contributions) by the 'appropriate percentage'.

The 'appropriate percentage' used to calculate the benefit is based on the CO_2 emissions. From 6 April 2010, the lower threshold (the CO_2 emissions figure which sets the 15% rate) was reduced from 135 to 130 g/km. This reduction will see an increase in the tax paid for many UK company car motorists. The rises have been imposed as the UK government looks to raise an additional £120 million from company car drivers and attempts to encourage them to make "greener" choices. Drivers with cars emitting no more than 120g/km are currently subject to a special favourable rate of 10%, although most diesel vehicles are taxed at 3% more than a petrol car with equivalent emissions.

Despite the tax rises for many company car users, legislation introduced in 2010 makes a reduction to the chargeable benefit where a car has an approved CO_2 emission figure of between 1 and 75 g/km. Company cars within this threshold will be subject to a new rate of just 5 per cent of their list price (subject to the 3% diesel supplement) and the measure will have effect from 6 April 2010 to 5 April 2015.

The company car tax thresholds will tighten further with effect from 6 April 2011 with the lower threshold being reduced from 130 to 125 g/km. From 6 April 2011, there will also be the following changes:

- The £80,000 'cap' for the price of a car for car benefit purposes will no longer apply.
- There will no longer be any reductions for alternative fuels (hybrids, bi-fuels and cars manufactured to run on E85 – types H, B and G).
- The diesel surcharge will apply to all diesels (including type L diesels approved to Euro IV emissions limits and first registered before 1 January 2006).

The rule changes will continue into April 2012 as the special rules for qualifying low emissions cars (for this purpose, those with CO_2 emissions not exceeding exactly 120 g/km) will be overhauled. The 'appropriate percentage' rate of 10% will apply to cars with CO_2 emissions of between 76 g/km and 99 g/km, which is a notable reduction from the current upper level of 120 g/km. The rate for emissions of 100 g/km will be 11% and will increase by 1% for every 5 g/km to the current maximum of 35%, as at present. This will lead to many company car drivers who currently benefit from the 10% rate having a significantly increased yearly tax charge.

COMPANY CAR – FUEL BENEFIT

The taxable company car fuel benefit charge is calculated by multiplying the fuel benefit charge multiplier by the same percentage as applies for the car benefit, which is based on the CO_2 emissions of the car.

It is the view of the UK government that the provision of free fuel to company car drivers provides a perverse environmental incentive. Consequently from 6 April 2010 the fuel benefit charge multiplier was increased from £16,900 to £18,000 per annum which will increase the total cost of the benefit for both employee and employer. If the employee pays for the full cost of all fuel for private journeys (such as home to work) there will be no car fuel benefit. In all other cases, the full tax charge will be due. Note that the increase covers a two year period, and is in reality less than fuel price inflation over the same period.

COMPANY VAN – FUEL BENEFIT

From 6 April 2010 the figure used as the basis for calculating the tax charge on the benefit of private fuel used by an employee in a company van was increased from £500 to £550 pa.

Unlike company cars, if the only journeys you make in the van are work journeys or journeys between home and work, you do not pay a benefit tax charge. As an employer, you must be in a position to show HM Revenue & Customs that there is no private use. This means you could be asked to

- keep mileage records
- sign an agreement about the van use
- have restrictions on the use of the van put into a contract of employment

ELECTRIC COMPANY CARS AND VANS

With effect from 6 April 2010, employees and directors who are provided with a company car or private use of a company van that is propelled solely by electricity will not have to pay tax on the benefit. Employers will also not have to pay Class 1A National Insurance contributions on such vehicles. The relief will apply for five years. Currently electric cars are taxed on list price, but are subject to a discount from the "relevant percentage" under the alternative fuel rules referred to above.

Additionally, subject to confirmation of compatibility with the EU State aid rules, businesses that buy new, unused electric vans will also be able to claim a 100% first-year capital allowance. The measure will apply to expenditure from 1 April 2010 for companies, and 6 April 2010 for unincorporated businesses.