Cutter & Co

ICAEW CHARTERED ACCOUNTANTS

CIOT CHARTERED TAX ADVISERS

www.davidcutter.co.uk

3 Lyttleton Court, Birmingham Street, Halesowen, West Midlands B63 3HN
Tel: 0121-550-8525 Email: info@davidcutter.co.uk

Business motoring - tax considerations

A business can provide cars for business owners, directors or employees through an outright purchase, a hire purchase contract or by way of a business car lease (BCL). There are different tax impacts of these options both for the business and for the individual taking the car.

In the summary below, we compare the tax treatments for a business of outright purchase with a BCL as, in recent years, hire purchase is becoming less popular than a BCL. We then look at the tax effects of a car being provided to employees or cash allowances to allow them to buy their own car.

Tax treatment for the business

Outright purchase

Capital allowances are available for business cars bought outright. The allowance is an annual amount calculated on a reducing balance basis. The percentage rate of the allowance depends on the CO_2 emissions of the vehicle. For both 2016/17 and 2017/18 this can be summarized as follows:

g/km emissions	Allowance
0 to 75*	100%
76 to 130	18%
Over 130	8%
* New cars only, used cars would receive an annual allowance of 18%	

It should be noted that cars are not eligible for the Annual Investment Allowance of 100% but vehicles which are not cars could qualify - this is looked at in more detail later in this Briefing.

A particular problem for companies

Companies are required to pool all car purchases along with other plant and machinery acquisitions into either the main pool which attracts the 18% WDA or the special rate pool which attracts the 8% WDA. This may also apply to an unincorporated business where the car is provided for an employee. The key tax implication of pooling is that on a disposal any unrelieved balance of expenditure is not immediately relieved for tax but instead the balance continues to be written down year on year by the 18% or 8% allowance. This could take many years to relieve the true cost incurred by the company or business.

Sole traders and partners

A car used by a self-employed person where there is part non–business use will be separately allocated to a single asset pool. The annual allowance will initially depend on the CO_2 emissions and then the available allowance will be restricted for the private use element.

On the disposal of the car, a balancing allowance is made which will provide tax relief to the extent that the sale proceeds are less than the balance of expenditure not relieved by the 18% or 8% allowances (after a restriction for the private use element).

A self-employed person can alternatively claim tax deductions for a car on a 'simplified expenses' basis. Business miles are recorded and a tax deduction is given at a rate of 45p for the first 10,000 miles in a year and 25p for miles above 10,000.

Business car lease

A BCL could take the form of a contract hire (also known as an operating lease) or a finance lease. Under a contract hire arrangement monthly lease payments are paid to the car lessor over a period, for example three years, and at the end of the lease the car is returned to the lessor. The lease payments cover the running costs of the car apart from insurance and fuel.

A finance lease arrangement involves paying monthly amounts over an agreed period which cover the cost of the vehicle, plus interest. Alternatively lower monthly amounts are paid and a final 'balloon payment' is charged based on the resale value of the vehicle. At the end of the contract the vehicle is either sold by the user to an unrelated third party or kept by the user on a peppercorn agreement.

Finance leased assets will generally be included in the business accounts as fixed assets and depreciated over the useful business life but as these vehicles do not qualify as a purchase at the outset, the expenditure does not normally qualify for capital allowances.

The tax relief for both contract hire and finance leases is based on the amounts that are charged to the profit and loss account. For finance leases this will be depreciation, interest and finance charges. For contract hire the lease payments on operating leases are treated like rent and are deductible against profits.

However, where the lease or hire charge relates to a car, there may be a portion disallowed for tax purposes. The disallowed portion applies where the emissions of the car exceed 130g/km and is 15% of the allowable deductions. The restriction does not apply to any service element of the expense.

In addition, for a self-employed person, the business will only be able to claim the business portion of any expenses. This applies to rental and lease costs, and other running costs such as servicing, fuel etc.

Business car provision for employees

Provision of company car

Where vehicles are provided to employees irrespective of the form of business structure (sole trader/partnership/company), a taxable benefit generally arises on the employee for private use. A tax charge may also apply where private fuel is provided for an employer provided vehicle. For the employer all such taxable benefits attract 13.8% Class 1A National Insurance contributions.

Car benefit

When a car is provided for the exclusive use of a particular employee, a taxable benefit is calculated based on the list price of the car and the level of its CO_2 emissions.

This is intended to encourage business car drivers and their employers to choose more fuel efficient vehicles. A diesel car attracts an additional 3% supplement each year (due to other pollutant emissions).The maximum percentage is 37% but every year more cars fall into the 37% category as the percentages charged for each band are increased.

Fuel benefit

If free fuel is provided with an employer provided car for private motoring then a fuel benefit tax charge also arises. This is based on a 'fixed' list price multiplied by the car benefit percentage for that employee. The 'list price' for calculating this has increased substantially over recent years and is now £22,200 for 2016/17 (£22,600 for 2017/18). This means that if an employee has a 28% car benefit percentage and also receives fuel for private motoring, then the fuel benefit for 2016/17 will be: £22,200 x 28% = £6,216.

Alternative cash allowance

Instead of providing a business car, some employers provide a cash allowance alternative to employees. This allows employees to either buy their own car or take out a personal contract hire. Personal contract hire is the same as business contract hire described above but for an individual.

The employee would pay PAYE and Class 1 NIC on their cash allowance at their marginal rate. If the employee then incurs business mileage in their car the employer could pay them a mileage allowance of up to 45p a mile for the first 10,000 miles and 25p over 10,000 miles. The rate is designed to cover all the costs of car ownership, for example petrol, deprecation and servicing.

If the rate paid by the employer is below these amounts, the employee could claim tax relief on the difference.

Example

Mark is a higher rate taxpayer. He is offered a company car which would result in a taxable benefit of £5,200 and so his tax liability at 40% would be £2,080. Alternatively he could have a cash allowance of £5,000 a year but he would pay 40% tax and 2% Class 1 NICs on the cash allowance, leaving him with £2,900.

He would pay about £325 per month for a personal contract hire, £3,900 for the year. Taking the cash allowance would therefore result in a cost of £1,000.

However what will the company pay him for business mileage? Assume reimbursement is 12p per mile if a company car (to cover petrol) and 45p/25p otherwise (mileage dependent, to cover all motoring costs).

On average Mark has 6,000 miles of business mileage pa. So he would receive an extra £1,980 (6,000 x 33p) if he uses his own car. But he would have to pay for road tax, servicing, repairs and insurance.

Salary sacrifice

Employers have used salary sacrifice arrangements to provide benefits in kind such as company cars as this resulted in income tax and NIC savings. However the government has recently announced that they intend to change the tax and NIC rules for these arrangements. If you need further details of these changes please get in touch.

Other matters to consider

Vans and double cab pick ups

The tax treatment of vans is different to cars and could be more beneficial.

- Vans that are purchased by a business either outright or under an HP agreement, are eligible for the Annual Investment Allowance on the basis that they are qualifying plant and machinery. This is a 100% allowance but a prescribed maximum is set annually and is currently £200,000.
- Where vans are provided for employees with unrestricted private use, there is a flat rate benefit charge per annum of £3,170 for 2016/17 (£3,230 for 2017/8). Where an employer provides fuel for unrestricted private use an additional fuel charge of £598 (£610 for 2017/18) also applies.
- VAT can be reclaimed on the purchase of a van (although there may be a potential restriction if there is non-business use).

Complications can arise on classification of a vehicle as a van or a car especially as the definitions are different for capital allowances and employee benefit purposes compared to the VAT definition. There are some vehicles known as 'double cab pick ups' (DCPUs) which could fall within the definition of a van and therefore benefit from all the tax advantages described above. Not all DCPUs will be treated as vans. An important condition is that the van should have a payload of one tonne or more.

There are also other van-derived vehicles known as 'combination vans'. HMRC has produced a list of vehicles that come within the definition of a van - see goo.gl/c3KYG1. However, HMRC do not always accept that such vehicles are vans for capital allowances and employee benefit purposes.

VAT and cars

Generally VAT cannot be reclaimed on the purchase of a new car. If the business leases a car, it can usually claim 50% of the VAT. The business may be able to reclaim all the VAT if the car is used only for business and is not available for private use. There are different methods available for claiming back the VAT on business trips.

A business can usually reclaim the VAT for:

- all business-related running and maintenance costs, eg repairs or off-street parking
- any accessories fitted for business use.

This can be done even if the business cannot reclaim VAT on the vehicle itself.

If you want more details on any aspect of business motoring please do not hesitate to get in touch.