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This briefing focuses on the current tax position of business motoring, a core consideration of many businesses. The overall aim is to provide a clear explanation of the tax deductions available on different types of vehicle expenditure in a variety of business scenarios and the tax liabilities which arise when vehicles are provided for employees/ directors.

Tax aspects of business motoring 2008/09

Methods of acquisition

Motoring costs, like other costs incurred which are wholly and exclusively for the purposes of the trade are tax deductible but the timing of any relief varies considerably according to the type of expenditure. In particular, there is a fundamental distinction between capital costs and ongoing running costs.

Purchase of vehicles

Where vehicles are purchased outright, the accounting treatment is to capitalise the asset and to write off the cost over the useful business life as a deduction against profits. This is known as depreciation.

The same treatment applies to vehicles financed through hire purchase with the equivalent of the cash price being treated as a capital purchase at the start with the addition of a deduction for the finance charge as it arises. However the tax relief position depends primarily on the type of vehicle, and the date of expenditure.

A tax distinction is made for all businesses between a normal car and other forms of commercial vehicles including vans, lorries and some specialist forms of car such as a driving school car or taxi.

Tax relief on purchases

Vehicles which are not classed as cars are now eligible for the Annual Investment Allowance (AIA) for expenditure incurred on/after 1 April 2008 for companies or 6 April 2008 for the self employed. This allowance allows a100% write off against profits on plant and machinery purchases of £50,000 per year.

Where purchases exceed the AIA, a writing down allowance (WDA) is due on any excess in the same period. This has been set at a rate of 20% for future periods but is generally between 20-25% for current accounts periods ending in 2008/09 due to transitional rules.

Cars are not eligible for the AIA so will only benefit from the WDA.

Example

Barber Limited has a year to 31 March 2009 and purchases a commercial van for £20,000 and a car for a member of the sales team costing £11,500. £5,000 of other plant and machinery is acquired during the period.

As this period falls wholly after 1 April 2008 the full £50,000 AIA is available and any excess of expenditure including any non qualifying car expenditure will attract WDA.

As the van and the plant expenditure do not exceed £50,000, the £25,000 spent will attract 100% relief. The car will attract only a 20% allowance of £2,300 for this period (11,500 x 20%) giving £27,300 of allowances in total.

Comment

The effect of reducing the tax liability of the business with such allowances depends on the type and size of business. For a small company such as in the above example the tax rate is 21% so the company's tax liability is reduced by £5,733. For a sole trader who pays higher rate tax and whose trading profits are in excess of the upper limit for National Insurance the effective tax saving is 41% x £27,300 = £11,193.

Complex cars!

The green car

Cars generally only attract the WDA but there is one exception to this and that is where a business purchases a new car with low emissions – a so called 'green' car. Such purchases attract a 100% allowance to encourage businesses to purchase cars which are more environmentally friendly.

The rules on this were updated for expenditure on/after 1 April 2008 so that the 100% write off is only available where the CO_2 emissions of the car do not exceed 110 grams per kilometre (g/km). The cost of the car is irrelevant and the allowance is available to all types of business.

What about expensive cars?

The purchase of a car other than a green car in excess of £12,000 is treated as an expensive car for tax purposes and has to be recorded separately to other plant additions. Although in theory it currently attracts a normal WDA of 20-25%, this is capped at £3,000 per annum. However, due to the requirement that such cars have to be recorded separately for tax, when such cars are disposed of an extra allowance may be obtained, referred to as a balancing allowance.

Continued overleaf >>>

The future

Budget 2008 announced that the government will promote the take up of cleaner cars through reforms to the taxation of business travel. It appears that from April 2009 the basis for calculating allowances will change from cost to CO_2 emissions as follows:

- cars up to 110 g/km will attract a 100% allowance;
- cars from 111-160g/km will attract a 20% WDA; and
- cars with emissions of more than 160g/km will only attract a 10% WDA.

However, at present the full details of the changes have not been confirmed.

Comment

It is not expected that there will be any requirement to record cars separately for tax except where there is private use (see below). In other words they will be pooled in either a 20% or 10% pool. The significance of this is that no extra balancing allowance will be available on disposal.

Example

The following table compares the current position and the proposals where a car is purchased for a manager at a cost of £18,500 and sold at the end of three years for £5,500, where the car has CO_2 emissions of 160g/km or less.

	Current rules Car > £12,000 £	Up to 160g/km CO_2 - relief at 20% £
Year 1 - cost	18,500	18,500
Allowance	3,000 (max)	3,700
Amount to carry forward	15,500	14,800
Year 2 - allowance	3,000 (max)	2,960
Amount to carry forward	12,500	11,840
Year 3 - sale	(5,500)	(5,500)
Balancing allowance	7,000	None
Year 3 - allowance	-	1,268 (6,340 x 20%)
Total allowances over three year life in business	13,000	7,928

Comment

The non availability of a final allowance when the car is sold is clearly not as beneficial as the current position and may affect decisions about providing cars for employees and directors.

Alternatives to purchase

What if vehicles are leased?

The first fact to establish with a leased vehicle is whether the lease is really a rental agreement or whether it is a type of purchase agreement, usually referred to as a finance lease. This is because there is a distinction between the accounting and tax treatment of different types of leases.

Tax treatment of rental type operating leases (contract hire)

The lease payments on operating leases are treated like rent and are deductible against profits. However where the lease relates to a car there may be a portion disallowed for tax. For 2008/09 this applies where the car has a retail price when new which exceeds £12,000. An adjustment is made to disallow part of that excess.

For 2009/10 onwards it appears that a disallowance of 15% will apply for cars with CO_2 emissions which exceed 160 g/km. It is assumed that the old rule will apply for existing contracts and that the new rule will apply for new contracts from April 2009.

Example

Existing contracts

If a car has a retail list price of £20,000 and an annual lease charge of £6,000, there would be a disallowance of £1,200 so only £4,800 would be tax deductible.

New contract from 1 April 2009

For a car with 166 CO_2 emissions and a £6,000 annual lease charge the disallowed portion would be £900 so £5,100 would be tax deductible.

Tax treatment of finance leased assets

These will generally be included in your 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 qualify for capital allowances unless classified as a long funded lease. Tax relief is generally obtained instead by allowing the accounting depreciation and any interest/ finance charges in the profit and loss account - a little unusual but a simple solution! A disallowance still applies if the vehicle is an expensive car.

Private use of business vehicles

The private use of a business vehicle has tax implications for either the business or the individual depending on the type of business and vehicle.

Sole traders and partners

Where you are in business on your own account and use a vehicle owned by the business - irrespective of whether it is a car or van - the business will only be able to claim the business portion of any allowances. This applies to capital allowances, rental and lease costs, and other running costs.

Providing vehicles to employees

Where vehicles are provided to employees irrespective of the form of business structure - sole trader/partnership/ company - a taxable benefit generally arises for private use. A tax charge may also apply where private fuel is provided for use in an employer provided vehicle. For the employer such taxable benefits attract 12.8% Class 1A National Insurance.

Cars

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 company car drivers and their employers to choose more fuel-efficient vehicles as the lower the emissions the lower the taxable benefit.

An illustration of how this works is as follows

For a car with a list price including VAT of £21,600 and CO_2 emissions of 185 g/km the benefit would be 25% x £21,600 = £5,400.

The percentages range for 2008/09 from 15% to 35% for most cars.

A diesel car generally has lower CO_2 emissions than a petrol equivalent but generally attracts an additional 3% supplement each year, due to other emissions.

Comment

There are a number of detailed rules which can reduce the charge such as unavailability and contributions made by the employee/ director, so if you are concerned with the precise tax position please contact us for further information.

Environmentally friendly cars

A new 10% tax band for non-electric cars emitting no more than 120g/km applies for 2008/09. The 3% diesel supplement still applies.

Example

Jane has a petrol car with a list price of £9,107 and CO_2 emissions of 111 g/km. The benefit for 2008/09 calculated as follows:

£9,107 x 10% = £910.

Fuel and cars

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 for 2008/09 from £14,400 to £16,900. This means that if an employee has a 25% car benefit percentage and also receives fuel that the fuel benefit, for 2008/09 will be: £16,900 x 25% = £4,225

Vans

No charge applies where employees have the use of a van and a restricted private use condition is met. For details on what this means please contact us. Where the condition is not met there is a flat rate charge per annum of £3,000 for the unrestricted private use. Where vans are shared a reduction is made to the benefit on a just and reasonable basis.

Where an employer provides fuel for unrestricted private use an additional fuel charge of £500 will also apply.

If you would like further details on any matter contained in this briefing please do get in touch.