It's easier to leaseplan

Company Car Taxation 2014
Your Guide

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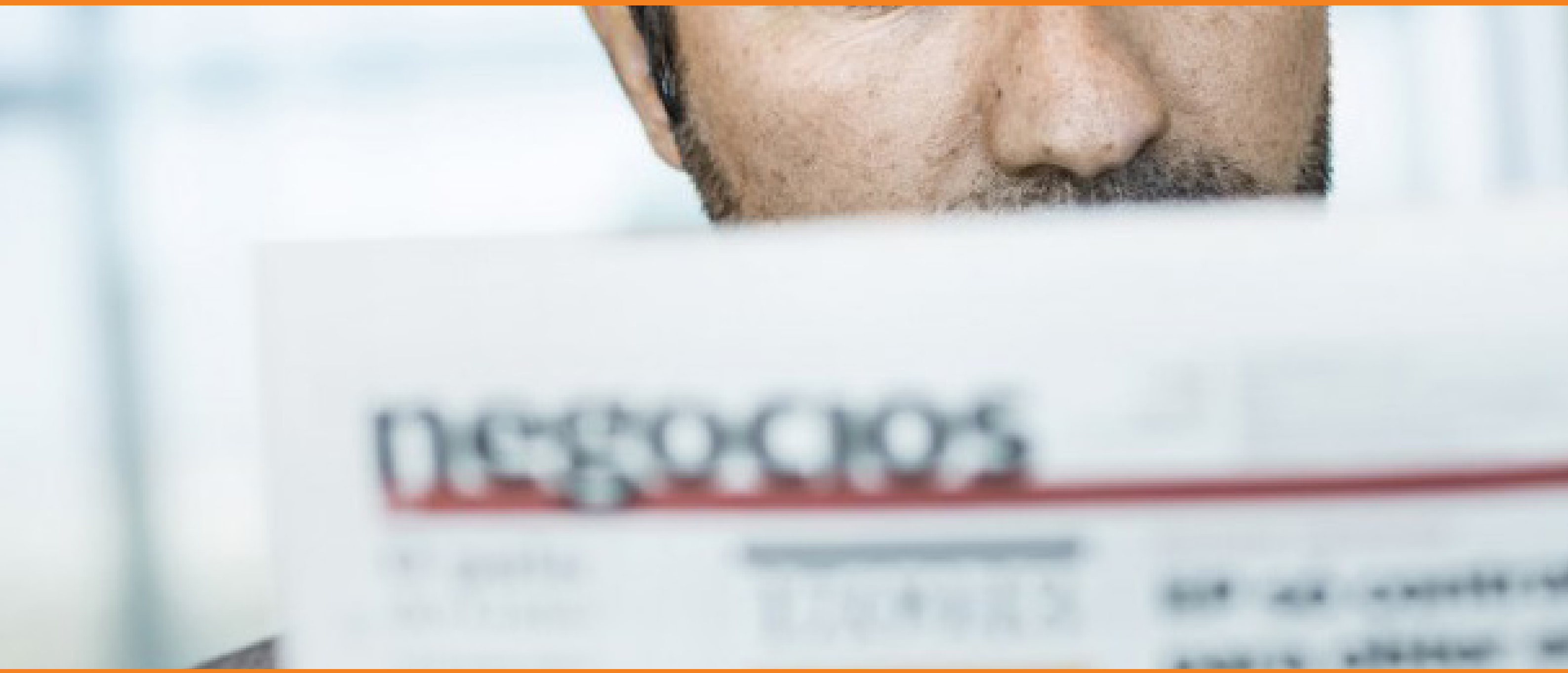

Company Car Taxation – *Your Guide*

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FOREWORD

We are pleased to once again publish our comprehensive annual Guide to Company Car Taxation. As in previous years we have worked closely with Deloitte in the development of the guide, ensuring we provide you with the most up to date and specialist financial and tax related content.

We should begin by saying that the impact of taxation as a cost driver to the fleet market remains as significant as ever. Inside our guide you will find a wealth of information and analysis to inform you when optimising the acquisition and operation of your company car fleet and associated benefits policy.

As you would expect from any taxation publication, the guide provides a detailed look at this year's Budget announcements including:

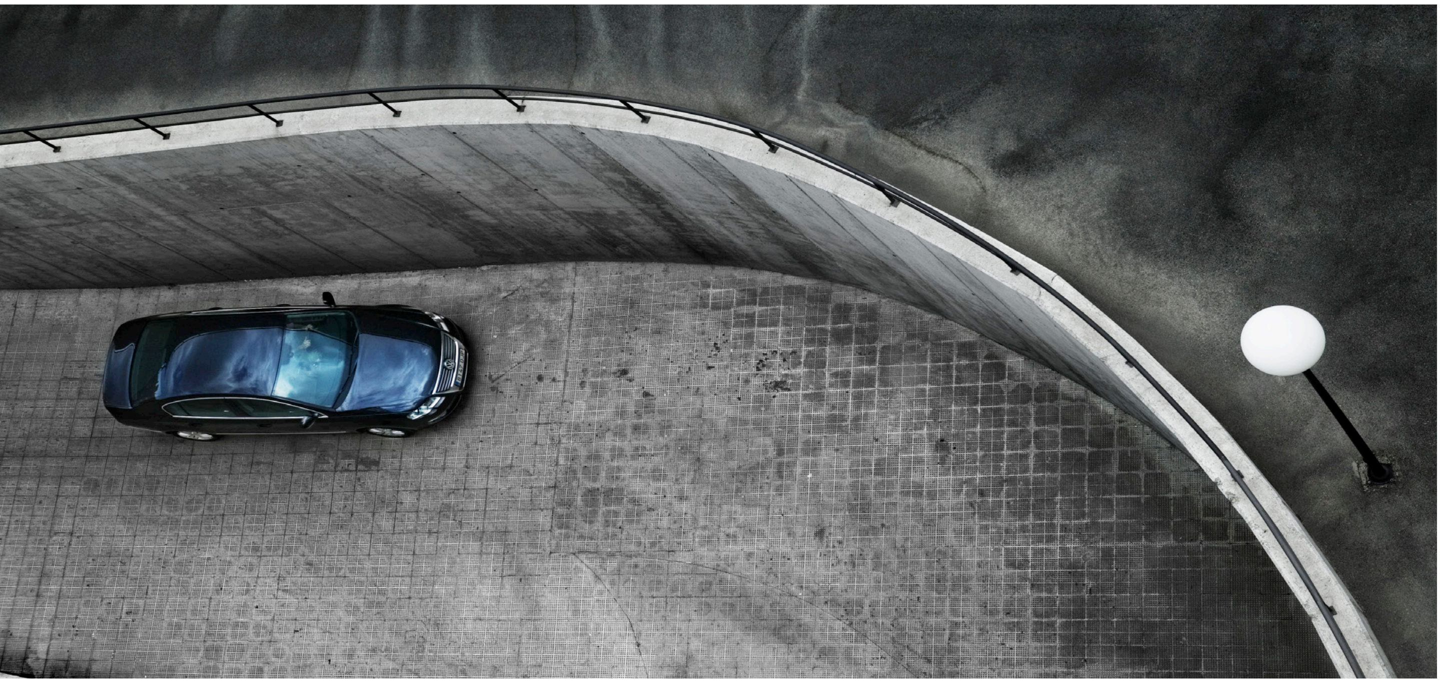
- The newly announced Company Car Tax thresholds up to 2018/19 Tax Year
- The extension until March 2018 of the 100% first year allowances for zero emission goods vehicles and the reduced CO_2 threshold of 75g/km applied to cars
- The reduction in the rates of corporation tax from 23% to 21% and, in future years to 20%

This guide provides you with a timeline related to these changes along with those announced in previous budgets; the impact of some of which are only now beginning to be felt.

A proportion of the development time on this document was spent translating the effects of Budget changes into 'real world' situations. This means you will find detailed examples demonstrating exactly how the evolution of taxation policy will impact your overall fleet costs and we examine how individual elements or 'levers' of fleet policy are affected by changes. In addition we include some details of recent tax cases in order to illustrate how tax policy continues to evolve.

As you are of course aware, taxation is only one of the many elements that will influence your fleet strategy. With this in mind our guide also provides you with comprehensive information on wider fleet considerations to help ensure that you have the most effective fleet policy in place.

In the past year LeasePlan Consultancy Services have updated our Automated Consulting Tool (ACT). Since its introduction, ACT has already proved to be extremely



popular, bringing clarity and simplicity to vehicle choice, funding methods, life cycle taxation impacts and fleet policy options, providing valuable insight into optimising the operation of our customers' fleets.

I would invite you to get in touch with your LeasePlan account contact to understand how the Budget changes may have affected your fleet, through demonstration of the ACT tool – or indeed, if you have any other questions related to this guide.

We hope that once again this proves to be a useful reference document over the coming year and that it demonstrates our expertise and what 'easier to leaseplan' really means for our customers.

With kind regards,

Matt Dyer, Managing Director,
LeasePlan UK.

INTRODUCTION

The company car plays a vital role within many companies – both as a key component in a business's service delivery and providing a vital element of the employee reward proposition. Furthermore, with close to 3 million company cars on the road in the UK the business car fleet is a continuing area of focus for the Government. As a direct result of the increase in company car tax announced for 2017/18 and 2018/19, the Government expects to raise an additional £720m in revenue in these two years from company car drivers and businesses, which demonstrates the scale and importance of company cars in the UK. The 2014 Budget is once again a good time to remind ourselves of the existing rules governing company cars as well as looking at the changes that are either occurring now, or that are on the horizon.

From a company perspective, a car may be provided for a number of different reasons, from using it as a tool of the trade which can be critical to an employee carrying out their job, to providing employees with a benefit, which reflects the employee's value to the company. It can also be expensive for the company to provide, often being the third most expensive payroll cost after salary and pensions. Regardless of the reasons behind the decision to provide company cars, a company will have to consider many of the same core issues to make sure it's company car arrangements are fit for purpose and deliver on strategic objectives, which often includes the triple bottom line of People, Planet and Profit.

For the employee receiving a company car, regardless of whether they receive a car as a "job need" user, or a "benefit" car, there is often a significant level of emotion attached to the type of car available and the terms of its use. Such significance is often not attached to other benefits an employee might receive. The company car will fulfil a number of roles, from being a mobile workplace during the week, to the main car in a household ferrying the family about at weekends, to the weekend driving enthusiast. Therefore, it is important that a company car scheme can offer the flexibility to keep people with quite different requirements content and to provide a useful and desirable benefit.

For the Government, with challenging targets to reduce carbon emissions, the sheer number of company cars on the road and their business use presents a significant opportunity to reduce CO_2 emissions by encouraging certain behaviours, such as opting for cars with lower emissions or travelling less by road.

When considering the scale of the issues impacted by company car provision it is understandable that getting things wrong is a worrying prospect and could be very expensive for a whole host of reasons.

About this book

This book has been prepared to highlight some of the key issues that fleet, finance, tax, HR and reward professionals should consider when reviewing the company car fleet.

With a greater awareness in society of the need to curb pollution, to which cars and their use are a major contributing factor, the Government has sought to use the UK taxation system to influence the design and delivery of company car policies by companies and the way in which employees choose their car.

It was for these reasons that in 2002 the current system of taxing an employee based on the carbon dioxide (CO_2) emissions of a company car were introduced. Simply put, higher polluting cars began to attract higher personal tax bills for employees. Due to the way that the tax and National Insurance system works, this in turn led to higher National Insurance Contributions (NIC) for the company. Subsequent changes to company car tax rules in later years further increased the tax cost of higher polluting cars. In 2009 the rules relating to tax relief for business expenditure were also changed to provide a financial incentive for companies to offer cars with lower emissions to employees. However, the current benefit in kind incentives for nil and Ultra Low Emission vehicles, when compared to vehicles outside theses emission bands, will not be as significant as it has been in the recent past.

As part of an effort to provide stability and clear visibility for companies considering their options before committing to any investment, HMRC will announce some rules a number of years in advance of when the changes come into force – the Budget this year confirmed the rates for the 2017/18 and 2018/19 tax years, giving clarity on rates for five years. With many companies operating car fleets with a replacement cycle of 3 or 4 years, changes announced with several years notice still need to be taken into consideration by both the employee and the company to help avoid unpleasant surprises.

Environmental concerns are also helping drive other changes within the car industry. Emerging technologies, such as electric vehicles and hybrid vehicles are also starting to become a more common sight on Britain's roads. The success of such technologies at a fleet level will be very much dependent on vehicle "whole life cost", the operating range and an appropriate and wide reaching infrastructure for vehicle charging.

These are exciting but challenging times for everyone involved in fleet policy design and delivery and this book is a handy reference guide to the key tax and technical issues that need to be addressed before financially important decisions are made.

2014 BUDGET – HEADLINES

Over recent years the Chancellor has used the Budget to announce changes to thresholds, rates and allowances within the existing structure of the rules governing company car taxation. The Budget this year followed a similar pattern, with the announcement of a number of changes that will impact both companies and employees.

The current company car tax system and the rules for corporation tax related to car provision are designed to encourage choice of lower emission vehicles. The changes announced are mainly alterations to thresholds within the current system which are designed to deliver a greater pressure on existing levers. Although the changes may appear relatively minor, it is important to understand the impact of these to ensure that costs do not increase unnecessarily.

The main headlines from the Budget 2014 were:

- The published company car tax rates show the continuing trend of increasing tax charges on company cars, with a 2% rise in the CO_2 thresholds for company car tax announced for 2017/18 and 2018/19 tax years. This means there will now be a 2% rise applying for each of the next four tax years. However, it should be considered that the 3% diesel supplement is removed in 2016.
- The financial advantage of cars in the two Ultra Low Emission Vehicle (ULEV) bands of company car tax will start to diminish in future years. The 4% difference between the 0-50g/km and 51-75g/km ULEV bands compared to the 76-94g/km company car tax band will be reduced to 3% in 2018/19, then 2% in 2019/20.
- The announcements of rules to the end of the 2018/19 tax year now provide company car tax rates for almost five years.
- The car fuel benefit charge multiplier for company cars and vans will increase in line with inflation (based on RPI).
- Vehicle Excise Duty rates will increase in line with inflation (based on RPI).
- The Government will extend van benefit charge support for zero emission vans on a tapered basis through to April 2020, when the van benefit charge will be equalised for both zero emission and conventionally fuelled vans.
- The Enhanced Capital allowances (ECA) available for zero emission goods vehicles will be extended to 31 March 2018.

As noted above, there has been a recent trend to announce changes in policy, some up to five years in advance of their actual introduction so as to allow companies and company car drivers to make informed decisions on the cars they choose. The Budget this year was in line with this.

The combination of changes in the taxation of company cars that could have a noticeable financial impact and a greater level of clarity on changes for the coming years, means that making informed decisions today can help to manage the cost of company cars for years to come.

The following sections of this book examine the Budget 2014 announcements in more detail alongside some of the core concepts on company car and business taxes that are intended to assist in understanding the potential impact of the Budget 2014 for companies and their employees.

THE 2014 BUDGET IN DETAIL

The 2014 Budget was delivered on March 19 and contained a number of announcements related to car provision, with the main changes continuing the trend of increasing company car tax in future years. The changes announced, in addition to those from previous years which came into effect from April 2014, will impact companies providing cars to their employees, and the employees themselves.

It is important when analysing the detail of the Budget announcements to relate them to the financial implications for employers and company car drivers. The following pages detail important announcements from the Budget 2014, and rules previously announced, set out in order of when they will come into effect and grouped into core subject areas that relate to the concepts covered later in the book to provide an easy reference point for the reader.

A TIMELINE OF CHANGES

From April 2014

Corporation tax relief

- A 2% reduction in the rate of corporation tax, with the main rate reduced from 23% to 21%.
- The Enhanced Capital Allowances for zero emission goods vehicles extended until 31 March 2018.

Company car benefit

- 0% Company Car Tax (CCT) rate for zero emission cars.
- 5% CCT rate for cars with CO_2 emissions of 1-75g/km.(1)
- The CCT rates for cars with CO_2 emissions exceeding 75g/km increased by 1 percentage point (starting at 11%). (1)

Business and private fuel provision

- The car fuel benefit charge multiplier was increased to £21,700.

From April 2015

Corporation tax relief

- There is to be a 1% reduction in the rate of corporation tax with the main rate reduced from 21% to 20%.
- Reduction in threshold for first year capital allowances for low emission company cars from 95g/km to 75g/km.

Company car benefit

- The 0% CCT rate for zero emission cars will be withdrawn.
- Two new CCT bands for low emission cars will be introduced from April 2015. Cars with CO_2 emissions of 0-50g/km and 51-75g/km, will attract CCT rates of 5% and 9% respectively.(1)
- The CCT rates for cars with CO_2 emissions exceeding 75g/km is set to increase by 2 percentage points (starting at 13%).(1)
- The upper rate for company car tax will increase from 35% to 37%.

Business and private fuel provision

- The car fuel benefit charge multiplier is to increase in line with the RPI.

From April 2016

Company car benefit

- CCT rates are set to increase by 2 percentage points (this includes cars with CO_2 emissions of 0-50g/km and 51-75g/km).
- The CCT rates for cars with CO_2 emissions exceeding 75g/km is set to start at 15%.
- The 3% surcharge applied to diesel cars is set to be abolished.

National Insurance Contributions (NICs)

- The Class 1 NIC rates (employer and employee) in relation to employees who are in a Contracted-Out Salary Related pension scheme will rise and everyone except for the self-employed will pay the same rates of NICs and build up access to the same single-tier State Pension.

(1) subject to a 3 percentage point surcharge for diesel cars.

From April 2017

Company car benefit

- CCT rates are set to increase by 2 percentage points (this includes cars with CO_2 emissions of 0-50g/km and 51-75g/km).
- The CCT rates for cars with CO_2 emissions exceeding 75g/km is set to start at 17%.

From April 2018

Company car benefit

- The CCT rate for cars with CO_2 emissions of 0-50g/km is set to increase by 4 percentage points to 13%
- The CCT rate for cars with CO_2 emissions of 51-75g/km is set to increase by 3 percentage points to 16%
- The CCT rates for cars with CO_2 emissions exceeding 75g/km are set to increase by 2 percentage points (starting at 19%).

From April 2019

Corporation tax relief

- Enhanced Capital Allowances for zero emission goods vehicles are set to expire.

Company car benefit

- The differential in CCT rates for cars with CO_2 emissions between 0-50g/km and 51-76g/km and 76-94g/km is set to reduce to 2 percentage points.

WHAT WILL BE THE IMPACT OF ALL THE CHANGES?

The Budget 2014 included a number of announcements related to company car provision, many of which are interrelated and this will compound the potential impact for companies providing cars to their employees. To help illustrate the impact of the combined changes we have included three case studies which are based on fleet profiles for typical fleets in operation today. The case studies forecast the cost to the company of providing the three car fleets based on rules applicable before the Budget 2014 and then the same fleet taking account of new rules announced in the Budget. To ensure a full examination of the changes due the case studies include analysis demonstrating the implications for both leased and purchased company car fleets.

Case study assumptions

In each of the case studies the Weighted Average Cost of Capital (WACC) to the company is 10% and the business is able to fully recover VAT. The cars would be provided on a 48 month term and a contract mileage of 80,000 miles with the company reimbursing 50% as business mileage at HMRC's Advisory Fuel Rates.

Case Study 1

The profile of this fleet is typical of a 'job need' fleet containing 100 cars comprised of the following:

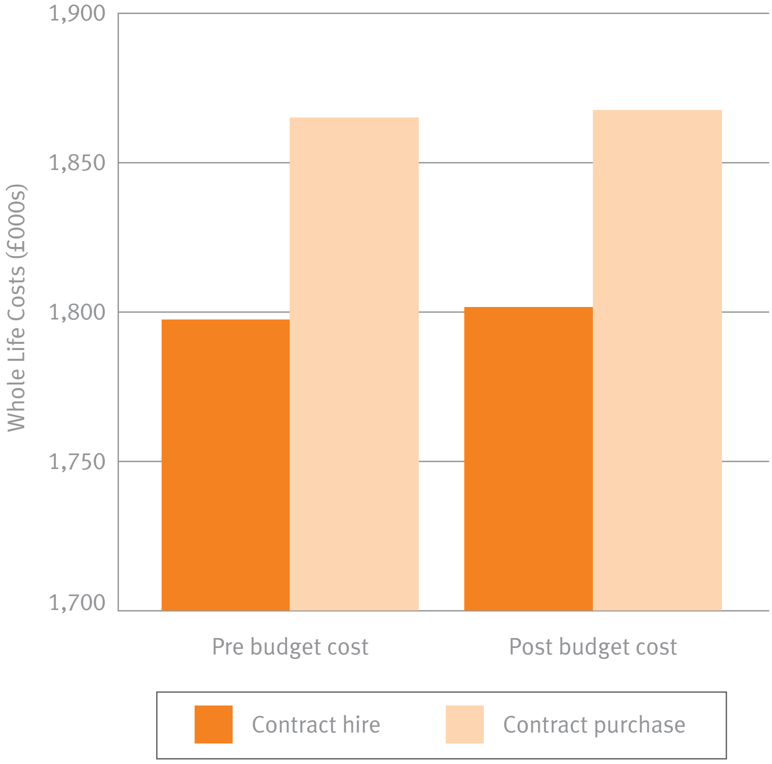
- 50 small diesel hatchbacks (e.g. Ford Focus) with CO_2 emissions of 109g/km;
- 40 large diesel hatchbacks (e.g. Vauxhall Insignia) with CO_2 emissions of 119g/km;
- 10 large diesel saloons (e.g. BMW 5 series) with CO_2 emissions of 119g/km.

Results

The table and chart below show the whole life cost to the company of funding the car fleet above based on rules before the budget (Pre Budget cost) compared to a fleet based on rules announced in the Budget where the cars are acquired in April 2014 (Post Budget cost).

Whole Life Cost to the company

Funding option	Pre budget cost	Post budget cost	Cost increase	Increase as %
Contract Hire	£1,796,140	£1,800,202	£4,062	0.2%
Contract Purchase	£1,862,912	£1,865,452	£2,540	0.1%



Observation

The cost of funding the car fleet above, either as a leased or purchased fleet, will rise as a result of changes in legislation that have been announced. However, the cost increase will be relatively small, with an average rise across the whole fleet 0.2% (leased), or 0.1% (purchased).

The main impact of the Budget 2014 for the cars analysed in this case study (diesel engine cars with CO_2 emissions between 109g/km and 119g/km) will come from the future rises in company car tax rates. However, with the increases in company car tax through to 2016/17 already known from previous Government announcements, there is only a small increase in company costs resulting from the changes announced in the Budget 2014.

Case Study 2

The profile of this fleet is a mix of typical 'job need' and 'perk' cars containing 560 cars comprised of the following:

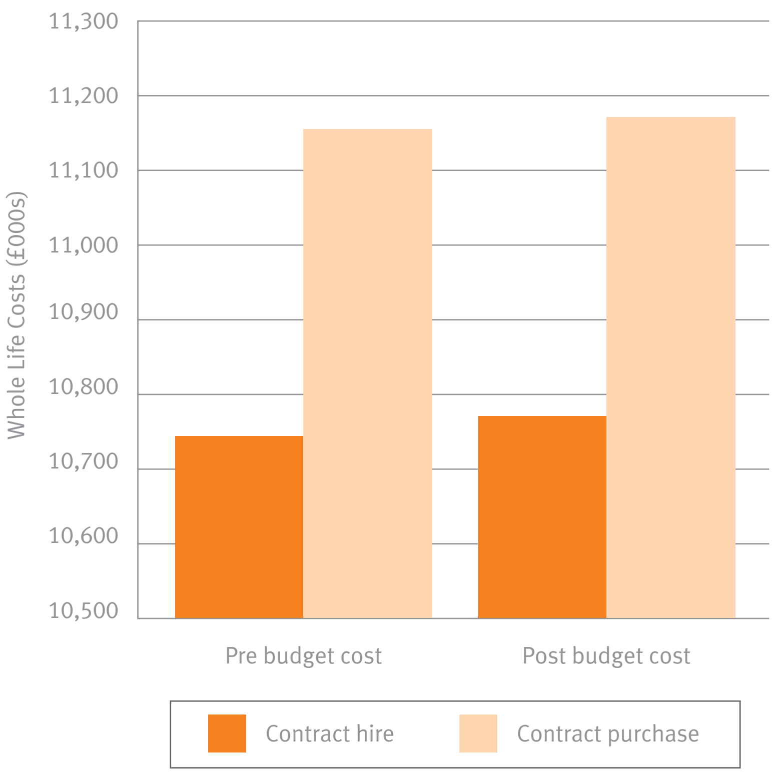
- 310 diesel hatchbacks (e.g. Ford Focus or VW Golf) with CO_2 emissions between 94g/km and 109g/km;
- 215 large diesel hatchbacks and saloons (e.g. Vauxhall Insignia or VW Passat) with CO_2 emissions between 110g/km and 135g/km;
- 35 large diesel saloons and estates (e.g. BMW 5 series or Mercedes E Class) with CO_2 emissions between 119g/km and 139g/km.

Results

The table and chart below show the whole life cost to the company of funding the car fleet above based on rules before the budget (Pre Budget cost) compared to a fleet based on rules announced in the Budget where the cars are acquired in April 2014 (Post Budget cost).

Whole Life Cost to the company

Funding option	Pre budget cost	Post budget cost	Cost increase	Increase as %
Contract Hire	£10,744,323	£10,769,409	£25,086	0.2%
Contract Purchase	£11,157,446	£11,172,748	£15,302	0.1%



Observation

The cost of funding the car fleet above, either as a leased or purchased fleet, will rise as a result of changes in legislation that have been announced. The average increase in cost across the whole fleet would be 0.2% (leased) or 0.1% (purchased).

The case study highlights the stability currently afforded by the legislation associated with the provision of company cars at this point in time. Previous changes which resulted in more significant cost rises, such as the reduction to 130g/km of the threshold for rules on leasing disallowance and capital allowances, have now taken effect and are reflected in both the pre and post budget costs. However, a good understanding of these rules is still important for a business to minimise fleet funding costs now, and any potential increases in future.

Case Study 3

The profile of this fleet is a typical 'perk' cars fleet containing 330 cars comprised of the following:

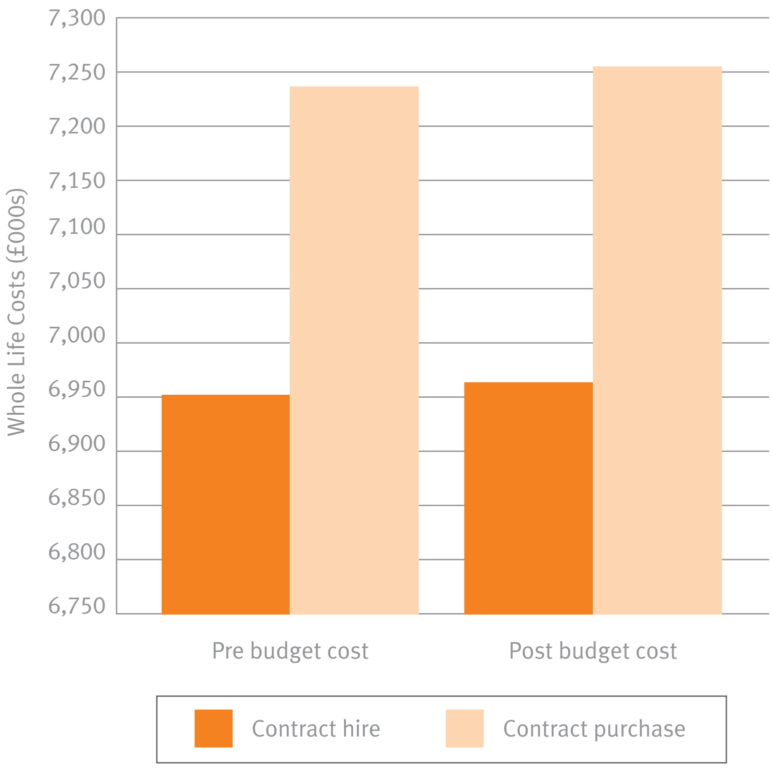
- 140 diesel hatchbacks (e.g. VW Golf or Honda Civic) with CO_2 emissions between 94g/km and 122g/km;
- 162 large diesel saloons and hatchbacks (e.g. VW Passat or Audi A4) with CO_2 emissions between 94g/km and 109g/km;
- 28 large diesel saloons and estates (e.g. BMW 5 series or Mercedes E Class) with CO_2 emissions between 119g/km and 139g/km.

Results

The table and chart below show the whole life cost to the company of funding the car fleet above based on rules before the budget (Pre Budget cost) compared to a fleet based on rules announced in the Budget where the cars are acquired in April 2014 (Post Budget cost).

Whole Life Cost to the company

Funding option	Pre budget cost	Post budget cost	Cost increase	Increase as %
Contract Hire	£6,950,033	£6,966,702	£16,669	0.2%
Contract Purchase	£7,243,722	£7,253,722	£10,000	0.1%



Observation

The cost of funding the car fleet above, either as a leased or purchased fleet, will rise as a result of changes in legislation that have been announced. The average increase in cost across the whole fleet would be 0.2% (leased) or 0.1% (purchased).

While the increase in funding costs between pre and post Budget rules is relatively small this year, it is worth noting that this will not always be the case and changes already announced, but yet to take effect, may trigger a much sharper rise in costs. For example, from April 2015 is has been announced that the threshold for 100% first year capital allowances for low emission company cars will be reduced. Under contract purchase, the car in the case study with CO_2 emissions of 94g/km would be impacted by this change and as a result the pre and post budget cost increase would jump from just 0.1% to 8.1%. Also, as the impact of the removal of the 3% diesel surcharge falls away, which currently negates a large element of the rises in company car tax rates for diesel cars over the next couple of years, the costs for fleets like those shown in these case studies will start to rise more sharply.

RECENT TAX CASES AND OFFICE OF TAX SIMPLIFICATION RECOMMENDATIONS

The legislative landscape surrounding company cars and related benefits continues to change as new legislation is introduced and changes are made to existing rules to ensure they remain relevant. Recently, the Government introduced legislation to protect tax revenues following recent tax cases relating to the provision of company cars. Also, the Office of Tax Simplification has made a number of recommendations which could have an impact in future for employers providing car and travel related benefits to their employees. The follow section provides a summary of the key issues announced.

Recent tax cases

Private use contributions

In the “Peter Marshall” case reported early last year it was held that payments made towards the private use of a company car made in the 2010/11 tax year could be used to reduce the company car BIK for the 2007/08 and 2008/9 tax years. The relevant legislation has been amended, with effect from 6 April 2014, so that only payments made in the tax year can be used to reduce the BIK for that tax year. In practice HMRC may allow private use contributions made prior to the form P11D deadline of 6 July following the tax year end in question to be used to reduce the BIK.

Apollo Fuels

In the Apollo Fuels case it was held at the Upper tribunal that a car leased directly from the employer to the employee at a fair market price should not be taxed as a company car. Such arrangements are not common and are generally confined to the fleet industry. The Government has introduced legislation with effect from 6 April 2014 to prevent abuse of the decision. HMRC did not challenge the First-tier Tribunal’s conclusion that NICs are not due on the mileage allowance payments made to company car drivers for business mileage. It is important to note that HMRC are appealing against the decision in the Apollo Fuels’ case.

Office of Tax Simplification (OTS) recommendations

A number of proposals have been put forward by the OTS to simplify the administration and taxation of benefits and expenses provided by employers' to their employees. Two recommendations of potential interest in respect of fleet administration are the payrolling of benefits and expenses, and a review of the travel and subsistence rules.

Payrolling benefits

The Government have agreed to consult on the voluntary payrolling of benefits. Such arrangements already are in place, however, currently when benefits are payrolled for tax there is still a requirement to report them on forms 'P11D' for reporting purposes and the payment of NIC. The proposal includes the removal of the requirement to report a payrolled benefit on form 'P11D'. This proposed change (if it is introduced) should remove the need to complete the form 'P46 Car', include the car on form 'P11D' and subsequently adjust the PAYE code of an employee to reflect the BIK on the car, if the car BIK is payrolled.

Travel and subsistence

OTS proposes a number of changes to the tax treatment of expenses incurred when an employee travels on business. One of the key proposals is to amend the rules so that an employee only has one work place treated as their permanent work place for tax purposes. In addition it is also proposed that reasonable travel and subsistence expenses associated with a temporary workplace should not attract a tax or NIC charge for the first two years, even if the assignment to the workplace is for longer than two years. Currently the "two year" rule only applies where the intention is for the assignment, at the temporary workplace, to be for two years or less.

TAXATION CONSIDERATIONS FOR COMPANY FLEETS

The impact of both direct and indirect taxation on company car fleets is a complex one. In the sections that follow we will explain the key taxation drivers and provide worked examples. We will also endeavour to deal with the key questions that fleet professionals often ask.

What is tax relief?

A company is subject to corporation tax on the taxable profits it makes as a result of doing business. In broad terms, taxable profits are calculated as income less expenses, subject to certain tax adjustments. So, if a company incurs a tax deductable cost that reduces its profits it should also reduce the amount of corporation tax it will pay and when this happens we say that the company has obtained "tax relief".

If a business is a sole trader or partnership then it should still receive tax relief when it incurs costs, but because the business is not structured as a "company", the precise nature of the tax relief differs to that of a company. The end result, however, is broadly the same. Also, there are some organisations, such as charities and some public sector bodies, where tax relief is not applicable as they are not subject to tax on their profits, but the rest of the information in this book will still make a handy guide.

Corporation tax rates

(for 1 April 2014 to 31 March 2015) (Financial Year 14/FY 14)	
Small Profits Rate	20%
Marginal Relief Lower Limit	£300,000
Marginal Relief Upper Limit	£1,500,000
Main rate of Corporation Tax (1)	21%

(1) The main rate will reduce by a further 1% in FY15.

Currently, there are two rates of corporation tax and the level of a company's profits in a particular tax year will determine which one applies. The two rates are:

- the lower rate which is called the 'small profits' rate; and
- the upper rate which is called the 'full' rate or 'main' rate

If a company's profits fall between the upper and lower limits, it will pay the full rate of corporation tax. However, it will receive marginal relief which has the effect of reducing the rate on a sliding scale between the upper and lower rate.

Following previous announcements in the Budget 2013, the main rate reduced to 21% this year, and it will drop to 20% from 1 April 2015, leaving it equalised with the small profits rate.

On the face of it, the calculation of tax relief for the cost of providing company cars should be relatively simple. However, the devil is in the detail and there are a couple of added complications for a company to consider and these depend on whether the company leases or buys the cars and the CO_2 emissions of cars provided.

HOW IS TAX RELIEF CALCULATED FOR A COMPANY THAT LEASES ITS COMPANY CARS?

If a company leases its cars then the lease rentals it pays are a cost which can be offset against profits, typically in the year that they are incurred. However, if the timing of the lease rentals is uneven, such as a large upfront or final payment, the timing of the tax relief will be spread evenly throughout the lease period rather than when the cost of lease rentals is incurred.

If the car has CO_2 emissions of 130g/km or below, then the full cost of the finance element of the lease rental will attract tax relief. Where a car has CO_2 emissions above 130g/km, 15% of the tax relief calculated is subject to a lease rental disallowance. Previously the CO_2 threshold was 160g/km.

Leasing rental restriction:

CO_2 emissions (g/km)	Allowed rentals	Leasing Disallowance
130 or below	100%	0%
Above 130	85%	15%

Let's look at some examples

To help illustrate how this might look in practice we have two examples that cover cars both below and above the CO_2 threshold. These show how tax relief would be calculated and the potential impact on the cost to the company of employees choosing cars with different CO_2 emissions.

Example 1: Tax relief for a leased car (CO_2 emissions of 130g/km or below)

A company leases a car using contract hire for a 36 month term with monthly lease rentals element of £400 *(for simplicity, in the examples we will assume the first lease rental is paid in the first month of the company's financial year)*.

The CO_2 emissions are 130g/km or below and so there is no lease rental disallowance to consider.

The calculation of tax relief for lease rental costs each year is:

	Yr 1 (FY14)	Yr 2 (FY15)	Yr 3 (FY16)	Overall
Lease rentals for tax relief	£4,800	£4,800	£4,800	£14,400
Corporation tax rate	21%	20%	20%	
Tax relief received	£1,008	£960	£960	£2,928

Example 2: Tax relief for a leased car (CO_2 emissions above 130g/km)

A company leases a car using contract hire for a 36 month term with monthly lease rentals of £400.

The CO_2 emissions are above 130g/km so there is a 15% lease rental disallowance on the tax relief that can be claimed.

The calculation of tax relief for lease rental costs each year is:

	Yr 1 (FY14)	Yr 2 (FY15)	Yr 3 (FY16)	Overall
Lease rentals for tax relief	£4,800	£4,800	£4,800	£14,400
Corporation tax rate	21%	20%	20%	
Tax relief for lease rentals	£1,008	£960	£960	£2,928
Less leasing disallowance	(£151)	(£144)	(£144)	(£439)
Tax relief received	£857	£816	£816	£2,489

Observation

Comparing the tax relief received by the company in the two examples shows the car with emissions below 130g/km CO_2 attracts additional tax relief for the company of £439 over the contract term. This means that it would be more expensive, after accounting for corporation tax, to provide the company car in example 2 even though they have the same lease rental.

WHAT OTHER TAX RELIEF CONSIDERATIONS ARE THERE FOR LEASED CARS?

When examining the tax relief implications of leasing company cars there are some further considerations worth bearing in mind. These include:

Q) What funding methods are considered to be a lease arrangement?

A) In this book where we refer to a lease, we will be talking about contract hire (also known as operating lease) or finance lease funding products and further details on these can be found in the section on funding options later in this book.

Q) Is tax relief calculated on the VAT exclusive or inclusive lease rental?

A) A company can claim tax relief on the lease rental charges after the recovery of any applicable VAT.

Q) Should I worry about capital allowances for leased cars?

A) Broadly, a company cannot claim tax relief through capital allowances on leased cars as capital allowances can only be claimed on company cars that are purchased.

However, it is important to be aware that where leasing companies purchase cars to lease to their customers the lease rentals charged may reflect the tax relief the leasing company can claim through capital allowances. So, even if capital allowances do not directly impact the company leasing its cars there may be some benefit from understanding how capital allowances work.

Q) What is the impact on tax relief if I pay a deposit or a number of lease rentals in advance?

A) Generally, a tax deduction is available for an expense when that expense is included in the company's profit and loss account in its financial statements (under generally accepted accounting standards).

What is generally not permitted is a tax deduction for lease rentals on the basis of when they fall due for payment. This is particularly true for leasing agreements where a large initial payment is made. In such lease agreements, the total lease rentals payable should be spread over the period of the lease (for both accounting and tax purposes).

Q) Can the company own the car at the end of the lease?

A) No. To be treated as a lease there must be no option for the company to purchase the car at the end of the lease term. If a company had such an option, the agreement would change from a lease to a deferred purchase, which would alter the accounting treatment. It is important to note that this does not prevent the individual driver from purchasing the vehicle directly from the lease provider.

HOW IS TAX RELIEF CALCULATED FOR A COMPANY THAT PURCHASES ITS COMPANY CARS?

When a company purchases a fixed asset, such as tools, machinery or a car, it is not usually possible to deduct the entire expenditure on the asset from the profits straight away on the basis that it represents capital expenditure. Instead, tax relief is calculated for qualifying capital expenditure by way of capital allowances, which effectively spreads the amount of tax relief that can be claimed over a number of years as opposed to the depreciation for accounting purposes, which is generally not deductible for tax purposes.

With company cars, there are special rules dictating the amount of capital allowances that can be offset against profits each tax year. This amount is calculated as percentage of the car's value, and the specific percentage is known as a Writing Down Allowance (WDA). The capital allowances are calculated on a 'reducing balance' basis. This means that the WDA percentage is applied each year to the remaining balance of unrelieved expenditure. The value of the car for tax purposes after the WDA has been applied each year is known as the Tax Written Down Value (TWDV).

As with leasing, the rules governing the calculation of capital allowances for purchased cars are structured to encourage the use of vehicles with lower CO_2 emissions. The table (below) shows the WDA rates applicable from FY14 onwards based on the car CO_2 emissions. It is important to note that unlike any leasing disallowance, the rules for capital allowances affects the timing of tax relief a company receives, rather than the actual amount of relief a company can claim.

From April 2014

g/km of CO_2	WDA rate %
95 or below(1)	100%(2)
96 – 130	18%
Above 130	8%

(1) The 95g/km threshold will fall to 75g/km in April 2015

(2) Relief provided for full purchase price in year 1

In order to simplify the process of tracking tax relief for cars purchased, all cars that do not receive 100% WDA are put into one of two tax pools (sometimes called an asset pool) based on their CO_2 emissions. If a car is purchased, the cost is added to the relevant pool and then when a car is sold the sale proceeds are deducted from the relevant pool. The appropriate WDA is then applied to the total value of each pool at the end of the company's tax year.

Let's look at some examples

To help illustrate how this might look in practice we have three examples, one for each WDA rate. They show how tax relief would be calculated and the potential impact for the company of employees choosing cars with different CO_2 emissions.

Example 1: Tax relief for a purchased car (CO_2 emissions 95g/km or below)

A company purchases a car for £25,000 outright and keeps it for 36 months, after which it sells the car for £10,000.

The CO_2 emissions of the car are 95g/km or below so it qualifies for 100% first year capital allowances.

The cash flows are as follows:

Year 1
The full purchase price of the car is added to the main pool and 100% of this can be offset against profits to provide tax relief.

Year 2
Full tax relief has already been provided so no further tax relief is allowed.

Year 3
The car is sold and the sale proceeds are added to the main pool after which capital allowances for the year are calculated.

Year 4 onwards
The remaining balance of capital allowances due, which in this case is a claw back (as the capital allowances previously claimed are in excess of the fall in value of the car during the ownership period) will continue to be accounted for over time within the main pool.

	Purchase		Disposal		
Year	Yr 1 (FY14)	Yr 2 (FY15)	Yr 3 (FY16)	Yr 4 (FY17)	Yr 5 (FY18)
Purchase price	£25,000				
Sale proceeds			(£10,000)		
TWDV	£25,000	£0	(£10,000)	(£8,200)	(£6,724)
WDA rate	100%	0%	18%	18%	18%
Capital allowances	£25,000	£0	(£1,800)	(£1,476)	(£1,210)
Corporation tax rate	21%	20%	20%	20%	20%
Tax relief	£5,250	£0	(£360)	(£295)	(£242)
Cumulative tax relief	£5,250	£5,250	£4,890	£4,595	£4,353
Total cumulative tax relief accrued after 75 years(1)			£3,250		

(1) It is assumed that corporation tax remains at 20% from FY15 onwards.

Example 2: Tax relief for a purchased car (CO_2 emissions 96 – 130g/km)

A company purchases a car for £25,000 outright and keeps it for 36 months, after which it sells the car for £10,000.

The CO_2 emissions of the car are between 96g/km and 130g/km attract a WDA rate of 18%.

The cash flows are as follows:

Year 1
The full purchase price of the car is added to the main pool. Capital allowances will be provided at the main rate of 18%.

Year 2
Capital allowances will continue at the main rate of 18%.

Year 3
The car is sold and the sale proceeds are added to the main pool after which capital allowances for the year are calculated.

Year 4 onwards
The remaining balance of capital allowances due (which in this case gives further tax relief) will continue to be accounted for over time within the main pool.

	Purchase		Disposal		
Year	Yr 1 (FY14)	Yr 2 (FY15)	Yr 3 (FY16)	Yr 4 (FY17)	Yr 5 (FY18)
Purchase price	£25,000				
Sale proceeds			(£10,000)		
TWDV	£25,000	£20,500	£6,810	£5,584	£4,579
WDA rate	18%	18%	18%	18%	18%
Capital allowances	£4,500	£3,690	£1,226	£1,005	£824
Corporation tax rate	21%	20%	20%	20%	20%
Tax relief	£945	£738	£245	£201	£165
Cumulative tax relief	£945	£1,683	£1,928	£2,129	£2,294
Total cumulative tax relief accrued after 75 years(1)			£3,045		

(1) It is assumed that corporation tax remains at 20% from FY15 onwards.

Example 3: Tax relief for a purchased car (CO_2 emissions above 130g/km)

A company purchases a car for £25,000 outright and keeps it for 36 months, after which it sells the car for £10,000.

The CO_2 emissions of the car are above 130g/km and attract a WDA rate of 8%.

The cash flows are as follows:

Year 1
The full purchase price of the car is added to the special rate pool. Capital allowances will be provided at the rate of 8%.

Year 2
Capital allowances will continue at the special rate of 8%.

Year 3
The car is sold and the sale proceeds are added to the main pool after which capital allowances for the year are calculated.

Year 4 onwards
The remaining balance of capital allowances due (which in this case gives further tax relief) will continue to be accounted for over time within the main pool.

	Purchase		Disposal		
Year	Yr 1 (FY14)	Yr 2 (FY15)	Yr 3 (FY16)	Yr 4 (FY17)	Yr 5 (FY18)
Purchase price	£25,000				
Sale proceeds			(£10,000)		
TWDV	£25,000	£23,000	£11,160	£10,267	£9,446
WDA rate	8%	8%	8%	8%	8%
Capital allowances	£2,000	£1,840	£893	£821	£756
Corporation tax rate	21%	20%	20%	20%	20%
Tax relief	£420	£368	£179	£164	£151
Cumulative tax relief	£420	£788	£967	£1,131	£1,282
Total cumulative tax relief accrued after 75 years(1)			£3,019		

(1) It is assumed that corporation tax remains at 20% from FY15 onwards.

Observation

The tax relief that could be claimed in all three examples will be calculated based on the depreciation in the value of the car. Because of the way in which capital allowances are calculated and the timing of when they are available, it is normally the case that tax relief relating to the depreciation in value of a car continues to accrue after the vehicle has been disposed of. This means that tax relief for a vehicle can effectively be provided over a period longer than the retention period of the vehicle. This period, as demonstrated below, can be a significant number of years.

It also needs to be noted that because the main rate of corporation tax is reducing (from 21% in FY 14 to 20% in FY 15), this will have a slight impact the overall amount of tax relief received.

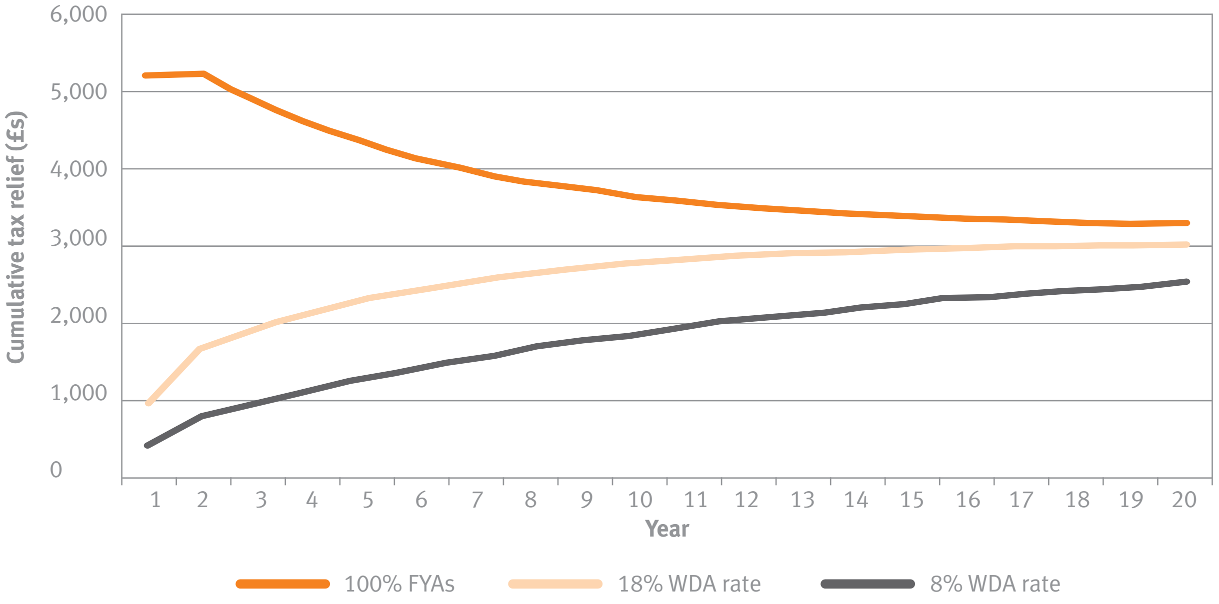
The effect of the above is that cars which attract capital allowances more quickly (due to lower CO_2 emissions) will receive an increased level of tax relief. This is because the corporation tax rate (and therefore the level at which relief is received for costs) is expected to reduce over the next few years. In summary, the reduction to the corporation tax rate increases the financial benefit of a company providing cars that receive tax relief more quickly.

The chart (below) compares the cumulative tax relief received by the company for the 3 examples which highlights the impact of the difference in the timing and value of tax relief received. This can be observed from the lines for the cumulative relief not converging as would be expected if the main rate of corporation tax was not falling.

If the tax relief calculations in the 3 examples were continued for 75 years to allow virtually all of the total tax relief to accrue, the tax relief received in example 1 would be £3,250, but the relief would be lower for example 2 (£3,045) and again for example 3 (£3,019).

If the main rate of corporation tax was static at 20% for the three examples above, it would take 90 years for the amount of tax relief received on a car with emissions above 130g/km to catch up with one with CO_2 emissions of 130g/km or below. This illustrates the degree to which a company's cash flow can be impacted by employees choosing cars with higher emissions.

A comparison of tax relief provided via capital allowances



What other tax relief considerations are there for purchased cars?

When examining the tax relief implications of purchasing company cars there are some further considerations worth bearing in mind. These include:

Q) What funding methods are considered purchases?

A) In this book where we refer to a purchase, we will be talking about contract purchase, outright purchase and hire purchase and further details on these can be found in the section on funding options later in this book.

Q) Does the company really get 100% tax relief in the first year on cars with CO_2 emissions of 95g/km or below?

A) Yes, this is correct. The 100% tax relief in the first year is called Enhanced Capital allowances (ECA) and it is part of a government initiative to encourage companies to purchase cars with lower CO_2 emissions. From 1 April 2013, cars with CO_2 emissions of 95g/km or below will be eligible for ECA until March 2015. From 1 April 2015, only cars with CO_2 emissions of 75g/km or less will be eligible for ECA. Currently, the ECA initiative for company cars is set to run until 31 March 2018.

VAT AND ITS IMPACT FOR A BUSINESS THAT LEASES ITS COMPANY CARS

What is the impact of VAT on providing cars?

Understanding the impact of VAT can play an important role in a company's decision on whether it should lease or purchase its company cars. Following changes to the VAT legislation in 1995, businesses that acquired cars wholly for business use, such as leasing companies, were able to fully recover the VAT element on cars. As a result, the lease rentals charged by leasing companies were reduced and leasing as a funding option became much more popular.

As with tax relief, the impact of VAT for a company providing cars will differ depending on whether the cars are leased or purchased and whether the cars are used exclusively for business purposes.

The first step in understanding the VAT treatment for a company that leases its cars is to separate out the cost of funding the car (this will be the lease rentals) and any other expenses related to the car (such maintenance, repairs etc.) as they are treated differently.

Lease rentals

In most circumstances, and subject to its own ability to recover VAT (i.e. full or partial VAT recovery), a company is only able to recover all of the VAT on lease rentals if the car is used entirely for business purposes.

In reality, few leased cars fulfil this criteria as most will have some element of private use and therefore there is a statutory 50% block in the VAT that would have otherwise have been recovered. HMRC accept that the 50% block on VAT reclaims for leased car payments only applies to the 'basic rental' element of the lease rental payments (i.e. not including any add-ons such as repair and maintenance).

Other expenses

The agreement that a company enters into for a leased car will frequently include the additional costs of running a car, such as maintenance, repairs and roadside assistance cover. However, as explained above, HMRC currently accept that the part of the payment which reflects these additional services is not subject to the same block as lease rentals and is eligible for a full VAT reclaim (again, subject to the company's ability to recover VAT).

To ensure the appropriate balance between lease rental charges and other expenses HMRC may review any agreements that appear to include a disproportionate element of other expenses. This is to ensure no advantage is made of this concession by inflating the cost of additional services, in order to engineer a larger VAT reclaim for the customer overall (and in effect, lowering the monthly lease rental payments).

Let's look at some examples

To help illustrate how this might look in practice we have prepared a couple of examples. These are for businesses with full and partial VAT recovery and show how the leasing costs are treated for VAT purposes.

Example 1: A company with full VAT recovery

A company leases a car using contract hire for a 36 month term with monthly lease rentals of £480 and maintenance costs of £60 (both inclusive of VAT).

VAT recovery rate	100%
Lease rentals	
Rental (inc. VAT)	£480
Full VAT recovery	(£80)
50% blocked VAT	£40
Rental (after VAT recovery)	£440
Other expenses	
Maint. (inc. VAT)	£60
Full VAT recovery	(£10)
Maint. (after VAT recovery)	£50
Total VAT reclaim	£50
Total cost to business after VAT reclaim	£490

Example 2: A company with partial VAT recovery

A company leases a car using contract hire for a 36 month term with monthly lease rentals of £480 and maintenance costs of £60 (both inclusive of VAT).

VAT recovery rate	5%
Lease rentals	
Rental (inc. VAT)	£480
Full VAT recovery	(£4)
50% blocked VAT	£2
Rental (after VAT recovery)	£478
Other expenses	
Maint. (inc. VAT)	£60
Full VAT recovery	(£0.50)
Maint. (after VAT recovery)	£59.50
Total VAT reclaim	£2.50
Total cost to business after VAT reclaim	£537.50

The monthly cost to the company in example 2 which is only able to reclaim 5% VAT will be £47.50 higher when compared to the company from example 1 which is able to reclaim 100% VAT.

VAT AND ITS IMPACT FOR A BUSINESS THAT PURCHASES ITS COMPANY CARS

The VAT treatment of purchased cars also has a different VAT treatment for the purchase of the car and the cost of other expenses incurred, such as repairs and maintenance.

Purchase of the car

No element of VAT can be recovered on payments for a car that is used, or is made available to be used, for private use and this broad definition disqualifies most cars from being eligible for a VAT reclaim.

This is a point that a number of companies have contested with HMRC, but with little success. Even in cases where the company has been able to demonstrate that a car was never actually used for private use, the fact that the car was theoretically available for private use has been sufficient to see claims fail at VAT tribunals.

Other expenses

The VAT treatment of other expenses for cars that are purchased follows that of leased cars where a full VAT reclaim can be made on the additional costs of running a car, such as maintenance, repairs and roadside assistance.

WHY SHOULD A COMPANY CARE ABOUT THE COMPANY CAR BENEFIT?

When employees receive a company car they will be taxed on the Benefit In Kind (BIK) liability. In this book we refer to the tax paid on the company car BIK liability as company car tax. The calculation of the BIK for an employee depends on a number of factors, but as with other legislation we have seen, this is designed to encourage the selection of lower CO_2 emission vehicles.

A company may not normally be too concerned with the amount of tax its employees pay in relation to the benefits they receive. However, there are a few points for companies to consider when it comes to company car tax. Firstly, a company will pay Class 1A National Insurance Contributions (NIC) on the value of the taxable benefit the employee receives. Therefore, employees choosing cars with lower company car tax costs will generally reduce their employer's NIC liability.

Secondly, with company car tax rates previously published, and those announced in the Budget 2014, company car tax costs will increase in coming years. There will now be a two percentage point rise in the rate of company car tax for most cars and this rise will take place every year through to 2018/19. As a result, for a typical diesel engine company car with CO_2 emissions of 110g/km, the increase in company car tax rates will see the BIK liability rise by 28% over a four year contract.

Finally, the BIK rules can be complex and difficult to understand leaving employees unsure of the implications of their choices. Helping employees navigate through this can encourage them to choose cars with lower emissions to manage their tax bill. Beyond the financial benefit to the company this can also lead to a more engaged workforce.

How do you calculate the company car benefit?

In the main, calculating the company car tax due on a company car is relatively straightforward although, like choosing a car, it can become more complex when you start to look at all the different options available.

The starting point for calculating a driver's tax charge on their company car is the list price of the vehicle, including the value of any optional extras purchased. This is also sometimes referred to as the "P11D value". For the purposes of the BIK calculation the *actual* price paid for the car is not relevant.

The next step in the calculation is to determine the car's "appropriate percentage". This is a percentage multiplier which is applied to the car's P11D value to calculate the BIK liability. The appropriate percentage can currently be anything between 0% and 35%, although typically for most current company cars it will be between 11% and 25%. As from April 2015 however, the maximum "appropriate percentage" will rise to 37%. The table (overleaf) shows the applicable appropriate percentage rates published by HM Revenue & Customs (HMRC) for the calculation of company car tax.

HOW DO YOU CALCULATE THE COMPANY CAR BENEFIT?

Company car tax rates

g/km of CO_2					% of list price (1)(2)
2014/15	2015/16	2016/17	2017/18	2018/19	
0	-	-	-	-	0
1 - 75	0 - 50	-	-	-	5
-	-	-	-	-	6
-	-	0 - 50	-	-	7
-	-	-	-	-	8
-	51 - 75	-	0 - 50	-	9
-	-	-	-	-	10
76 - 94	-	51 - 75	-	-	11
95	-	-	-	-	12
100	76 - 94	-	51 - 75	0 - 50	13
105	95	-	-	-	14
110	100	76 - 94	-	-	15
115	105	95	-	51 - 75	16
120	110	100	76 - 94	-	17
125	115	105	95	-	18
130	120	110	100	76 - 94	19
135	125	115	105	95	20
140	130	120	110	100	21
145	135	125	115	105	22
150	140	130	120	110	23
155	145	135	125	115	24
160	150	140	130	120	25
165	155	145	135	125	26
170	160	150	140	130	27
175	165	155	145	135	28
180	170	160	150	140	29
185	175	165	155	145	30
190	180	170	160	150	31
195	185	175	165	155	32
200	190	180	170	160	33
205	195	185	175	165	34
210	200	190	180	170	35
-	205	195	185	175	36
-	210	200	190	180	37

Company car tax rates previously announced   Company car tax rates announced in the Budget 2014

(1) Add 3% to the '% of list price' if the car runs solely on diesel, up to the limit of 35% to 2014/15 and 37% from 2015/16. From April 2016 the 3% surcharge for cars running solely on diesel will be abolished.

(2) It is proposed that the Government will review the company car tax bands for ULEVs in light of market developments at Budget 2016, to inform decisions on company car tax from 2020-21 onwards.

Let's look at some examples

To help illustrate how this might look in practice we have four examples for company cars with different CO_2 emissions and fuel types to show the potential employer and employee tax implications.

Example 1: A low emission diesel engine company car (CO_2 emissions of 85g/km)

In this example the driver is a 40% tax payer and the P11D value of the car is £25,000.

85g/km & diesel	2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018	Overall
Appropriate %	14%	16%	15%	17%	15.5%
BIK charge	£3,500	£4,000	£3,750	£4,250	-
At 40%	£1,400	£1,600	£1,500	£1,700	£6,200

The average appropriate percentage over the lifetime of the company car would be 15.5% and the employee would pay a total of £6,200 in company car tax.

Example 2: A petrol engine company car (CO_2 emissions of 115g/km)

In this example the driver is a 40% tax payer and the P11D value of the car is £25,000.

115g/km & petrol	2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018	Overall
Appropriate %	16%	18%	20%	22%	19%
BIK charge	£4,000	£4,500	£5,000	£5,500	-
At 40%	£1,600	£1,800	£2,000	£2,200	£7,600

The average appropriate percentage over the lifetime of the company car would be 19% and the employee would pay a total of £7,600 in company car tax.

Example 3: A diesel engine company car (CO_2 emissions of 115g/km)

In this example the driver is a 40% tax payer and the P11D value of the car is £25,000.

115g/km & diesel	2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018	Overall
Appropriate %	19%	21%	20%	22%	20.5%
BIK charge	£4,750	£5,250	£5,000	£5,500	-
At 40%	£1,900	£2,100	£2,000	£2,200	£8,200

The average appropriate percentage over the lifetime of the company car would be 20.5% and the employee would pay a total of £8,200 in company car tax.

Example 4: A higher emission diesel engine company car (CO_2 emissions of 155g/km)

In this example the driver is a 40% tax payer and the P11D value of the car is £25,000.

155g/km & diesel	2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018	Overall
Appropriate %	27%	29%	28%	30%	28.5%
BIK charge	£6,750	£7,250	£7,000	£7,500	-
At 40%	£2,700	£2,900	£2,800	£3,000	£11,400

The average appropriate percentage over the lifetime of the company car would be 28.5% and the employee would pay a total of £11,400 in company car tax.

As the example shows, the CO_2 emissions of the car act as a lever to encourage employees to select company cars with low emissions. The driver of a diesel car with CO_2 emissions of 155g/km would be £5,200 worse off over the 4 year retention period when compared to the driver of the car emitting 85g/km, even though both vehicles have the same P11D value.

Observation

The above examples show the financial impact of the increasing cost of company car tax for each individual vehicle. Where a fleet of cars is involved, this effect is magnified many times over. It also shows the importance of looking ahead to see what changes in tax rates and legislation have been announced and will come into effect in later years, as this can impact the tax position and overall cost considerably.

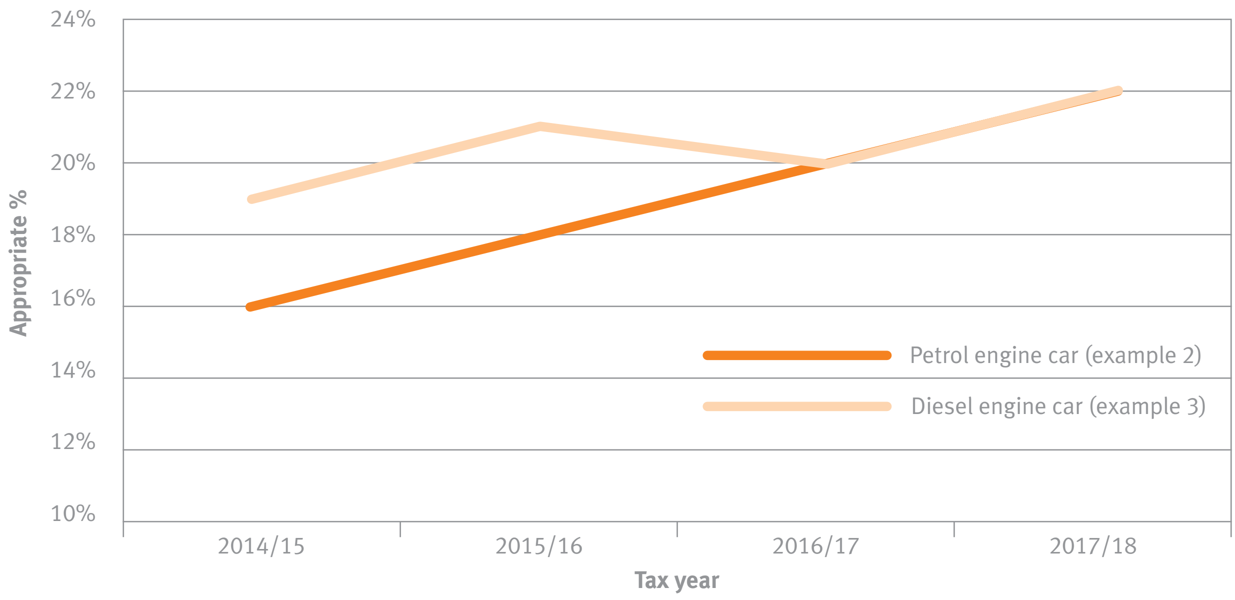
This upward increase in the appropriate percentage is sometimes referred to as the ‘ratcheting’ effect. Companies and their employees need to be aware of this effect and take it into account when choosing company cars, so as to avoid expensive surprises in the future.

To highlight the impact of the ratcheting effect, we can look at example 2 where the appropriate percentage for a petrol engine car will rise from 16% in the 2014/15 tax year, to 22% in the 2017/18 tax year – this is an increase of 38%. The driver of such a vehicle would therefore pay 38% more income tax in 2017/18, than in 2014/15.

It is worth noting that the removal of the 3% diesel surcharge in April 2016 will negate the ratcheting effect for some diesel engine cars in that year. The impact of this can be seen in example 3, where the appropriate percentage for a diesel engine car will rise from 19% in the 2014/15 tax year, to 22% in the 2017/18 tax year – this is an increase of 16% which is much lower than the equivalent petrol engine car.

The chart below displays the rise in the appropriate percentage for the cars shown in example 2 and 3 which illustrates how the removal of the 3% diesel surcharge negates the rise in the appropriate percentage in 2016. As a result, the ratcheting effect for the diesel engine car over the 48 month term (16%), is less than half that seen with the petrol engine car (38%).

Comparison of appropriate % rates for petrol and diesel engine car (CO_2 emissions 115g/km)



What other considerations are there for the company car benefit?

When examining the issue of company car benefit charges there are further considerations worth bearing in mind. These include:

Q) What is the impact of an employee adding optional extras to their company car?

A) If an employee chooses to add optional extras to the car before registration, the P11D value of the car is increased by the list price of the optional extras. It is important to note that even if the manufacturer describes an optional extra as 'free' (for example a free metallic paint or satellite navigation system), the P11D value is increased by the list price of the accessory.

If an employee adds optional extras to the car after the car has been registered and the total cost of the optional extras is more than £100, then the cost will be added to the P11D value. This will occur from the beginning of the tax year in which the optional extras were added. If the total cost of the optional extras does not exceed £100 then the total cost will be ignored.

Q) What happens if an employee makes a contribution towards the cost of the car?

A) Employee contributions towards the cost of providing a company car can be structured as capital contributions or private use contributions.

Capital contributions
If an employee contributes towards the capital cost of the car, whether that is towards the cost of the car or towards the cost of optional extras, the total contribution is deducted from the P11D value up to a maximum of £5,000. Typically, the payment of capital contribution would be made at or about the time when the car or accessory was provided.

Private use contributions
If an employee makes contributions as a condition of the car being available for private use, the total amount of the contributions can be deducted from the BIK for the tax year in which they were made. Typically, the payments for private use would be made throughout the time where the car is available. As a result of a recent tax case, the Government introduced new legislation in the Finance Bill 2014 to ensure individuals make payments for private use of a company car in the relevant tax year. It is important that the car scheme policy documentation is clear that such contributions are for the private use of the car.

Q) How will an employee know how much company car tax they are paying?

A) The BIK amount, calculated as explained earlier, is usually reported on an employee's annual Form P11D. This form reports taxable benefits received by an employee during the tax year.

Q) How is the employee's company car tax collected?

A) Typically, the company car tax is collected via an adjustment to the employee's PAYE notice of coding. The impact of this is that the employee effectively funds the company car tax that is payable to HMRC out of their monthly pay.

Q) Does the 3% diesel surcharge apply to diesel-electric hybrids?

A) HMRC confirmed that diesel-electric hybrid cars would not be subject to the 3% diesel surcharge for company car tax. The 3% diesel surcharge will be abolished for all diesel company cars from April 2016.

Q) What if the company car is off the road for some reason?

A) If a company car is unavailable to the employee for a continuous period of 30 days or more, the benefit charge is reduced by the proportion of the year for which the car is unavailable. This only applies to the car not being available to the employee. It is not sufficient for the employee to be physically unable to drive the car.

If a company car is unavailable for less than 30 consecutive days and a replacement car is made available, no BIK arises on the replacement car provided that it is of similar quality to the car that it is replacing. However a BIK charge will continue to apply based on the original company car throughout the period.

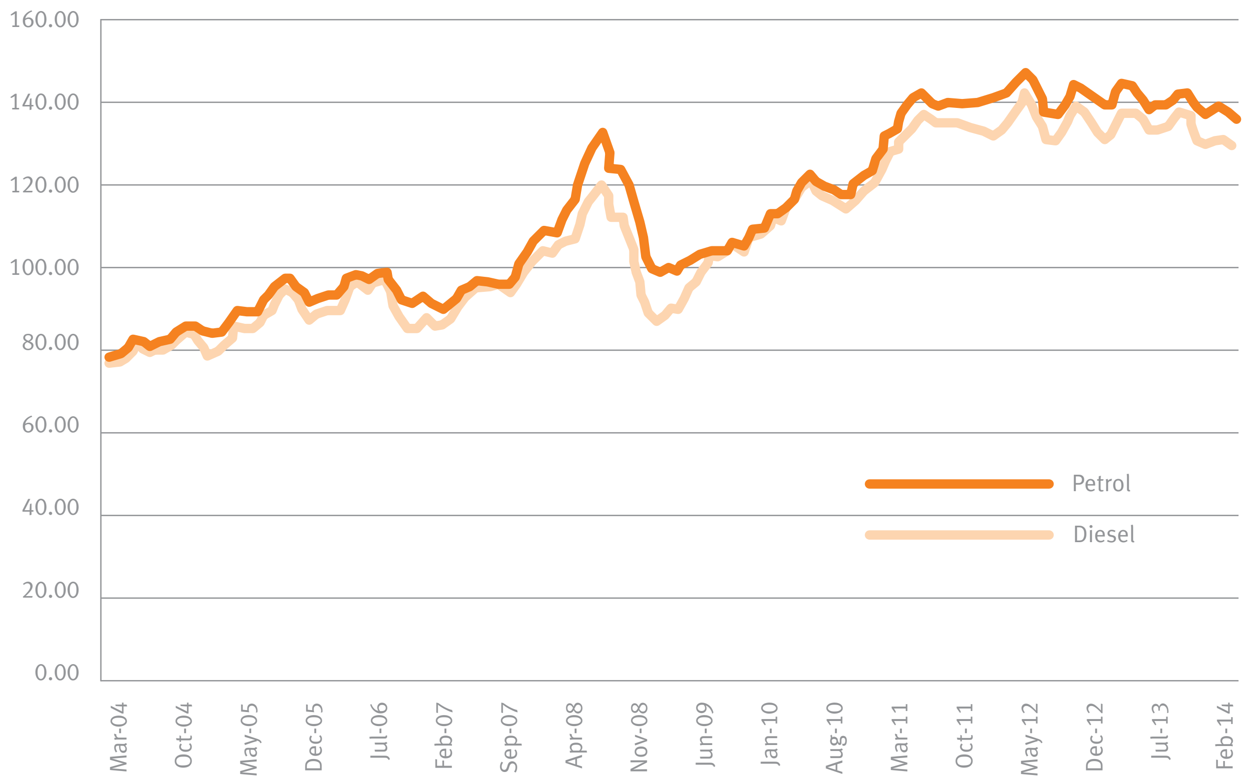
IS THE COST OF BUSINESS FUEL IMPORTANT?

When employees undertake business mileage on behalf of their company (for example visiting customers) they will generally be entitled to receive reimbursement from the company for the cost of the fuel they have used. The issue of business mileage reimbursement has become increasingly important in recent years due to the rising cost of fuel.

In the last 10 years the cost of petrol and diesel has risen by 67% and 64% respectively and continues to represent a significant cost for employers. The chart (below) shows the change in the average national price of petrol and diesel since 2004. Although there have been a number rises and falls, the general trend is hard to miss – fuel prices are rising.

There have been challenges for companies stemming from the rules that govern the level of reimbursement they can pay without incurring a tax liability. This is because reimbursement rates were not always able to keep pace with the rate at which fuel prices were increasing. As a result, some employees felt that the reimbursement they received did not actually cover the cost of the fuel they used for business mileage. This became such an issue that changes were made by HMRC to better deal with the reality of rapidly increasing fuel prices.

UK fuel prices 2004 – 2014



How can a company reimburse employees for the cost of fuel used?

If an employee uses their own funds to pay for fuel used on business journeys there are two principal methods for calculating the amount of reimbursement the employee receives. The method chosen can have an impact on costs, cash flow and the level of administration required for both the company and its employees.

Advisory Fuel Rates

Many companies use Advisory Fuel Rates (AFRs) to reimburse employees for business mileage as it can be simple to implement and administer. With AFRs, the employee reclaims the cost of business fuel based on an allowed rate as published by HMRC. The reimbursement rates a company can pay are published by HMRC periodically and they are intended to reflect actual average fuel costs at the time. The rates only apply where employers reimburse employees for business travel in their company cars or require employees to repay the cost of fuel used for private travel.
If the reimbursement rate paid per mile of business travel is no higher than the AFRs, HMRC will accept that there is no taxable profit for the employee on the payment and therefore no additional tax liability on top of the reimbursement paid. Using the AFRs (or rates below the AFR) can therefore reduce administration for the company.

Advisory Fuel Rates as of 1 March 2014			
Engine size (cc)	**Petrol**	**LPG**	**Diesel**
1,400 or less	14p	9p	
1,401 or 2,000	16p	11p	
Over 2,000	24p	17p	
1,600 or less			12p
1,601 or 2,000			14p
Over 2,000			17p

HMRC publish updated AFRs every 3 months, but this was previously every 6 months. The change followed a period of rapid fluctuation of fuel prices and the rates published quickly became out of date and did not reflect the cost of fuel which led to many employees arguing they were not adequately reimbursed for business fuel used.

Actual cost of fuel

An alternative method of reimbursing employees who undertake business journeys in a company car is to reimburse for the actual cost of fuel based on the miles driven and the fuel consumption of the car. If a company can demonstrate that the reimbursement reflects the cost of fuel used and does not provide any profit to employees then the reimbursement may be higher than the advisory rates without triggering a tax liability. The level of administration involved with this approach is greater than simply paying a pence per mile rate for each mile driven as more information is required and the onus is on the company to demonstrate to HMRC there is no profit to the employee within the reimbursement paid.

What happens if employees have a fuel card to pay for fuel they use?

Another mechanism used by companies to reimburse business mileage is the use of a fuel card.
In this situation fuel is paid for by means of a fuel card where the employee charges the cost of any fuel purchased to the card and the bill for the fuel is then paid by the company. The employee will then have to submit records to allow the company to distinguish between the fuel used for business purposes and that used for private mileage. To avoid a tax liability for the private fuel used the employee must reimburse their employer the cost of this fuel.

There are a number of reasons for using fuel cards, such as the bulk buying power providing a discount on the fuel purchased and the ability to reimburse actual cost of fuel. However, there is a certain level of administration that is necessary to demonstrate that no private fuel has been paid for by the company. If this cannot be demonstrated then HMRC may deem that a car fuel benefit has been provided and this can have significant cost implications for both the company and the employee.

What happens if a company provides private fuel?

Typically, if a company provides private fuel (called car fuel benefit) the fuel is paid for by means of a fuel card but unlike before, there is no requirement for the employee to keep any records or to reimburse for the private element of fuel used. The cost to the company of providing private fuel in this way will include the cost of fuel purchased, VAT implications and an employer's NIC liability in respect of the car fuel benefit provided to the employee.

From the employee's perspective this can be seen as an attractive benefit as they do not have to pay for their private fuel or keep any mileage records while their total fuel bill is paid by the company. However, employees will have to pay tax on the car fuel benefit which is calculated based on a number of factors including the CO_2 emissions of the car, the type of fuel used and a car fuel benefit charge multiplier set by the Government. It is important for employees to be aware that the calculation of the BIK is a fixed charge that does not take account of the value of any private fuel actually used. In many scenarios the employee may be paying more in income tax to receive the car fuel benefit than the value of the private fuel used.

Let's look at some examples

To help illustrate the implications of providing car fuel benefit, we have two examples showing the cost to the company and the tax implications for the employee where car fuel benefit is provided. Please note, the examples exclude the impact of any fuel purchased for business use.

Example 1: An employee travelling 5,000 private miles each year

The employee receives private fuel and drives a typical 4 door diesel engine company car with CO_2 emissions of 125g/km and fuel consumption of 55MPG. The assumed cost of fuel for this example is £1.36 p/l.

Company perspective

The cost to the company of providing private fuel benefit is:

Cost of private fuel purchased	£562
VAT recovery on fuel	(£94)
VAT fuel scale charge	£157
Employer's NI on fuel benefit	£629
Total cost (2014/15)	£1,254

Employee perspective

The tax cost for the employee as a result of receiving private fuel benefit is:

Private fuel scale charge	£21,700
Appropriate percentage	21%
Taxable benefit	£4,557
Tax paid (at 40%)	£1,823

Observation

The employee would have paid £1,823 in income tax to receive a car fuel benefit where the value of the fuel provided would have been £562. Therefore, the employee would have saved £1,261 (net) if they had personally purchased the private fuel. The cost to the company of providing the car fuel benefit, which would have left the employee £1,261 out of pocket, would have been £1,254.

Example 2: An employee travelling 15,000 private miles each year

The employee receives private fuel and drives a typical 4 door diesel engine company car with CO_2 emissions of 125g/km and a fuel consumption of 55MPG. The assumed cost of fuel for this example is £1.36 p/l.

Company perspective

The cost to the company of providing private fuel benefit is:

Cost of private fuel purchased	£1855
VAT recovery on fuel	(£309)
VAT fuel scale charge	£157
Employer's NI on fuel benefit	£629
Total cost (2014/15)	£2331

Employee perspective

The tax cost for the employee as a result of receiving private fuel benefit is:

Private fuel scale charge	£21700
Appropriate percentage	21%
Taxable benefit	£4557
Tax paid (at 40%)	£1823

Observation

The employee would have paid £1,823 in income tax to receive a car fuel benefit where the value of the fuel provided would have been £1,855. Therefore, the employee would have enjoyed a financial advantage of £32 (net) through receiving the benefit. The cost to the company of providing the car fuel benefit, worth only £32 to the employee, would have been £2,331.

The car fuel benefit charge multiplier has been the target of repeated increases in recent years, with the multiplier increasing by 28% over the last 5 years and now set at £21,700 for the 2014/15 tax year. The Government has announced that the multiplier is set to increase in line with the RPI in future.

What other considerations are there for fuel reimbursement?

When examining the issue of reimbursing for fuel there are further considerations worth bearing in mind. These include:

Q) Can a business recover VAT on the cost of business fuel purchased?

A) If a company pays business mileage reimbursement based on a pence-per-mile rate, such as HMRC's Advisory Fuel Rates, then they can reclaim VAT on the mileage rate paid. It should be noted that if the pence-per-mile reimbursement rate paid is above HMRC's AFRs, the VAT reclaim is usually limited to the amount based on the AFR rates.

If a company reimburses the actual cost of business fuel used then the VAT reclaim is based on the cost of the business fuel purchased.

Q) Can a business recover VAT on the cost of private fuel purchased?

A) It would not normally be possible to reclaim any of the VAT for private fuel used. However, HMRC recognise that for many companies, where a car is used for business and private motoring, the record keeping process to keep separate the two sets of mileages would be cumbersome.

HMRC therefore allow the use of what is known as the VAT fuel scale charge. The impact of the VAT fuel scale charge is that it effectively gives rise to a VAT cost to the company. This is because the company (as stated above) is also recovering VAT on the cost of all fuel purchased, which includes fuel for private mileage where VAT cannot usually be recovered. The VAT fuel scale charge is based on the CO_2 emissions of the car. The higher the CO_2 output of the car, the greater the VAT fuel scale charge.

Q) What information do employees need to submit when recording business mileage journeys?

A) Generally, employees will need to submit a fuel VAT receipt and document the business miles travelled. These items should be supplemented by other supporting evidence, such as the date, the reason for the journey or the postcode to postcode information. A company can keep any range of information, if they feel it will enhance the accuracy of their records. Ultimately, the company is required to demonstrate to HMRC, with supporting evidence, the extent of business mileage undertaken by employees.

Q) Can a company reimburse for business mileage below HMRC's Advisory Fuel Rates?

A) Yes. HMRC's Advisory Fuel Rates are not binding and they are intended to reflect average fuel costs. A company may reimburse fuel costs at less than these rates if they feel that this more appropriately reflects the actual fuel costs of their fleet, for example, their fleet may be comprised of fuel efficient cars, therefore requiring less fuel. Clearly, the rationale of any such decision would need to be carefully communicated to employees.

WHAT FUNDING OPTIONS ARE THERE FOR A COMPANY PROVIDING CARS TO ITS EMPLOYEES?

When a company is looking to provide cars to its employees there are a number of different funding options it can consider and the choice of funding route can have a significant impact on the cost as well as wider issues like administration and exposure to residual value risk. It is important for a company to look at all of these when looking to choose a funding option for its company car fleet.

Contract Hire

Contract hire is a lease funding option that is structured so the company simply hires the car for a predetermined period and mileage at a fixed monthly rental. The ownership of the car, and all associated risks, rewards and responsibilities are retained by the leasing provider. The lease rentals are fixed by the leasing provider at the outset of the agreement and usually take into account all costs associated with the car with the exception of maintenance costs, which can be included in an optional maintenance agreement if required.

The company will pay the agreed lease rental charges and maintenance costs if they were included and then at the end of the agreed term the company will hand the car back and settle any end of contract charges due based on the mileage and condition of the car.

There is no option for the company to purchase the vehicle at the end of the lease period and it must be handed back to the lease provider, although some leasing providers may under a discretionary arrangement allow an employee to purchase the car directly from them as a sale to a private individual.

The benefits of contract hire are:

- A fixed cost making budgeting more simple
- A small initial cost
- No exposure to residual value risk
- VAT recovery on the lease rentals (subject to 50% block)
- VAT is payable on each lease rental (as opposed to upfront)
- Corporation tax relief available against the lease rental charges
- Eliminates most of the stresses and financial risks of vehicle ownership
- Reduced car fleet administration

The potential downsides to contract hire are:

- The company will be tied into a fixed contract
- No ability to profit from residual values
- It will be necessary to forecast the expected term and mileage for the car at the outset of the contract
- There is no option for the company to purchase the vehicle

Finance lease

Finance lease is a lease funding option that allows the company to lease a vehicle for a fixed monthly fee. The structure of the arrangement also means that it transfers substantially all the risks and rewards of ownership of the vehicle to the company.

There are two main types of finance lease product that are offered, usually selected depending on the cash flow needs of the company, and these are known as a “fully amortised finance lease”, or a “finance lease with a balloon payment”.

Finance lease (fully amortised)

The lease rentals are based on the full cost of the car spread over the term of the contract and take no account of any anticipated residual value for the car. At the end of the agreement the car must be sold to a 3rd party and the company will receive an element of the sale proceeds as agreed with the leasing provider at the outset.

It is also possible with a fully amortised finance lease to take up the option of a secondary rental agreement for continued use of the car if this is required by the company. Generally, the capital cost and interest has been covered within the primary period and then a nominal “peppercorn rental” is charged for the secondary period which will be much less than the previous payments.

Finance lease (with balloon)

The lease rentals are based on part of the cost of the car, with a balance (the balloon) being offset to the end of the agreement, usually to reduce the lease rentals paid. At the end of the agreement the car must be sold to a 3rd party and sale proceeds that are in excess of the balloon payment can be retained by the company. If the sale proceeds fall short of the balloon payment the company will be responsible for any shortfall.

The benefits of acquiring a car under a finance lease are:

- The option to choose a fully amortised or balloon agreement to suit the cash flow needs of the company
- A small initial cost
- Usually, provided acquisition of title is optional rather than obligatory, VAT should be payable on each lease rental
- VAT recovery on the lease rentals (subject to 50% block)
- Corporation tax relief available against the lease rental charges

The potential downsides to a finance lease are:

- The company will be tied into a fixed contract
- Exposure to residual value risk for the company

Contract purchase

Contract purchase is a deferred purchase funding option that is structured so the company makes fixed monthly payments for a predetermined period and mileage and at the end of the agreement it has the option to purchase the car or hand it back to the leasing provider. The ownership of the car and some of the associated risks, rewards and responsibilities are retained by the leasing provider until the final balloon payment is made.

The monthly payments are fixed by the leasing provider at the outset of the agreement and usually take into account all costs associated with the car and the forecast balloon payment. As with contract hire, it is possible to include an optional maintenance agreement if required.

The company will pay the contracted payments and then at the end of the agreed term the company will have the option of meeting the balloon payment and owning the car or selling it back to the leasing provider at the price agreed at the outset. If the latter option is chosen there may be end of contract charges due based on the mileage and condition of the car.

The benefits of contract purchase are:

- A fixed-cost method of financing a vehicle purchase making budgeting more simple
- A small initial cost
- No exposure to residual value risk (if the car is sold back to the leasing provider)
- Potential residual value profit if the residual value is greater than the balloon payment due
- Tax relief provided via capital allowances
- Eliminates most of the stresses and financial risks of vehicle ownership
- Reduced car fleet administration

The potential downsides to contract purchase are:

- Upfront VAT cost, as supply of goods, not services
- VAT is ordinarily fully blocked
- It will be necessary to forecast the expected term and mileage for the car at the outset of the contract

Hire purchase

Hire purchase is a deferred purchase funding option that is structured so the company makes fixed monthly payments for a predetermined period and mileage. At the end of the agreement it has typically paid the full cost of the car and interest and ownership of the car transfers to the company. The ownership of the car is retained by the leasing provider until the final payment is made, however, the associated risks, rewards and responsibilities rest with the company.

The company will typically pay a deposit and then the balance of the cost of the car and any interest charges are spread evenly over an agreed term. As with other funding options, it is possible to include an optional maintenance agreement if required.

The benefits of hire purchase are:

- Greater degree of flexibility within the agreement
- No end of contract charges
- Potential residual value profit (compared to funding option with fixed residual value/balloon)

The potential downsides to hire purchase are:

- Upfront VAT cost, as supply of goods, not services
- VAT is ordinarily fully blocked
- Exposure to residual value risk
- Uncertain costs making budgeting more complex
- Management of the vehicles (purchase, disposal and maintenance) can be time consuming

Outright purchase

An outright purchase describes the straightforward situation where the company directly buys the car. The purchase is usually either funded through borrowings or use of the company's own cash resources. The ownership of the car and all of the associated risks, rewards and responsibilities rest with the company

An outright purchase involves a large upfront payment when the company purchases the car and when it is sold the company will receive the full amount of the sale proceeds. A company can request fleet management services to support ownership of a car in areas like servicing, roadside assistance and vehicle sale from a fleet provider if required.

The benefits of outright purchase are:

- The flexibility provided by full ownership of the car and no fixed contract
- No end of contract charges

The potential downsides to outright purchase are:

- Upfront VAT cost, as supply of goods, not services
- VAT is ordinarily fully blocked
- Exposure to residual value risk
- Uncertain costs making budgeting more complex
- Cash flow implication of the large upfront purchase cost
- Management of the vehicles (purchase, disposal and maintenance) can be time consuming

Blended Solutions

It is often the case that a 'blend' of the following funding options can deliver the optimal cost solution for a company. However, operating a blended policy can give additional administrative complexity which often drives companies to choose a single financing method for all the cars in their fleet.

HOW DO THE FUNDING OPTIONS COMPARE TO EACH OTHER?

The table below provides a simple way of comparing some of the key characteristics of the funding method explained above.

	Contract Hire	Finance Lease (fully amortised)	Finance Lease (with balloon)	Contract Purchase	Hire Purchase	Outright Purchase
What is the upfront payment/deposit?	Typically 3 months advance rentals (c8% of car cost)	Typically 10%-15% of car cost	Typically 10%-15% of car cost	Typically 3 months advance payments (c8% of car cost)	Typically 10%-15% of car cost	100% of car cost
Who owns the car?	The leasing provider	The leasing provider until the final payment is made	The leasing provider until the final payment is made	The leasing provider until the final payment is made	The leasing provider until the final payment is made	The company
Typically, who meets maintenance cost?	Leasing provider (assuming optional maintenance agreement is taken)	The company	The company	Leasing provider (assuming optional maintenance agreement is taken)	The company	The company
Who retains the residual value risk?	The leasing provider	The company	The company	The leasing provider	The company	The company
Typically, who is responsible for administration of the car? E.g. arranging road fund licence and disposal	The leasing provider	The company	The company	The leasing provider	The company	The company
Does the company own the car at the end of the contract?	No, it is returned to the leasing provider	No, it is sold to a 3rd party	No, it is sold to a 3rd party	Yes, subject to making the final payment	Yes, subject to making the final payment	Yes
Is the car treated as on, or off balance sheet?	Off balance sheet	On balance sheet	On balance sheet	On balance sheet	On balance sheet	On balance sheet
How does the company claim tax relief for car costs?	Monthly rental can be offset against profits for tax relief	Monthly rental can be offset against profits for tax relief	Monthly rental can be offset against profits for tax relief	Tax relief is provided via capital allowances	Tax relief is provided via capital allowances	Tax relief is provided via capital allowances
Can the company recover VAT on the rentals/payments made? (1)	Yes, subject to a 50% restriction	Yes, subject to a 50% restriction	Yes, subject to a 50% restriction	No	No	No
Can the company recover VAT on an optional maintenance agreement?	Yes, 100% of VAT can be recovered	Yes, 100% of VAT can be recovered	Yes, 100% of VAT can be recovered	Yes, 100% of VAT can be recovered	Yes, 100% of VAT can be recovered	Yes, 100% of VAT can be recovered

(1) Assumes that the car is made available for private use.

HOW ARE THE DIFFERENT FUNDING OPTIONS ACCOUNTED FOR?

The funding option chosen will ultimately determine the accounting treatment and this can be a significant part of the decision-making process for some companies, particularly for those with large company car fleets. Leasing provides the benefit of having a set monthly cost as well as being more flexible and avoiding working capital becoming tied up compared to an outright purchase. The decision as to whether to opt for contract hire or a finance lease or hire purchase arrangement currently makes a significant difference as to how the arrangement is treated within company accounts.

Contract hire

Under a contract hire agreement the car (an asset) is leased for a defined period and returned to the leasing provider (the legal owner) at the end of the agreed lease term. The asset is not capitalised in the balance sheet because from an accounting perspective the risks and rewards of ownership (typically the residual value risk) remains with the leasing provider.

Rental payments are typically charged to the profit and loss account on a straight line basis over the lease term.

Finance lease

Under finance lease contracts the car is treated as if it has been purchased outright and initially capitalised in the balance sheet at cost. It is then subject to an annual depreciation charge based on the estimated useful economic life and estimated residual value.

The lessee recognises an obligation to pay the future rentals in the balance sheet and the rentals payable are allocated between the finance charge and the capital amount (which equates to the fair value of the asset).

The total finance charge is allocated to accounting periods during the primary lease term on a constant yield basis and recorded as an expense in the profit and loss account.

Contract purchase

This has the same accounting treatment as finance lease.

Outright purchase

The cost of the car is capitalised in the balance sheet and an annual depreciation charge based on the estimated useful economic life of the car and the estimated residual value is shown in the profit and loss account. The car is recognised in the balance sheet at cost less accumulated depreciation.

Hire purchase

This has the same accounting treatment as finance lease.

How will lease accounting be affected by the current proposals for the reform of lease accounting?

The IASB recently announced its updated proposals for lease accounting following a joint meeting with the US Standard setter, the FASB, in March. In a simplification of the 2013 proposals, the IASB has now decided on a single model approach for lessee accounting, with all leases other than ‘short term leases’ and leases of ‘small assets’ to be accounted for on balance sheet, in a similar way to current finance lease accounting and in line with the treatment of Type A leases in the 2013 Exposure Draft (ED).

In respect of lessor accounting, lease classification is to be determined on the basis of whether the lease is effectively a financing or sale, using similar guidance to that contained within IAS 17. Lease classification would focus on whether substantially all the risks and rewards incidental to ownership of the underlying asset have transferred to the lessee. The IASB decided to eliminate the receivable and residual approach proposed in the 2013 ED, instead retaining an approach similar to current ‘finance lease’ and ‘operating lease’ accounting.

What next?

Further deliberations will continue in future Board meetings with the expected completion date of the project yet to be determined. There are currently no plans for a further exposure of the proposals for comment prior to the publication of a final Standard. Commentators originally expected a 2015/2016 effective date for the new leasing Standard (although this was never confirmed by the IASB). However, given the 2013 re-Exposure Draft, 2014 amendments and with further deliberations required to finalise elements of the latest proposals an effective date of 2017 or later may be more likely.

WHAT IS AN EMPLOYEE CAR OWNERSHIP SCHEME?

An alternative funding option for a company wishing to provide company cars to employees is an Employee Car Ownership Scheme (ECOS). Broadly, an ECOS is an arrangement put in place by a company that allows its employees to acquire a car, usually within a specified framework and from a single fleet provider. The scheme is usually designed to give similar benefits to a company car from the employee's perspective with the policy often remaining comparable in terms of how issues like car selection, support and servicing and reallocation are dealt with.

It is important to be aware that the term "Employee Car Ownership Scheme" is only one of many used by providers to describe arrangements of this type. Other descriptions which often refer to the same arrangement include:

- Employee Car Ownership – "ECO",
- Employee Car Ownership Plan – "ECOP"
- Structured Employee Car Ownership Plan – "SECOP"
- Employee Car Plans – "ECP"
- Personal Employee Car Ownership Scheme – "PECOS"

Although they broadly offer the same benefit, the different arrangements may also differ in terms of some of the detail of implementation and operation. In order to understand the exact nature of an ECOS, whatever the product description used, it is important to gain a detailed understanding of how it works by reading all the accompanying documentation.

How does an employee car ownership scheme work?

An ECOS will typically be used to provide a car to an employee but it is structured in such a way that the company car tax benefit does not apply. HMRC have set out the conditions under which a car provided to an employee will be classified as a company car and it will be important for a correctly structured ECOS to ensure these do not apply.

Where the employer is involved in implementing and/or operating the ECOS which will allow the employee to acquire a car then the car remains to be provided "by reason of employment". However, in order for a car to be a company car, it must also be provided "without any transfer of the property in it". Under an ECOS, the car is generally supplied via a Credit Sale Agreement (CSA) which transfers title to the employee at the outset. Because ownership of the car has passed to the employee it is not deemed to be a company car for tax purposes. This also means that for accounting purposes, cars provided using an ECOS are currently treated as off balance sheet which may be seen as beneficial by some businesses.

What are the implications of using an employee car ownership scheme?

The most common reason for a company to consider the use of an ECOS is the level of potential saving it could offer when compared to providing cars through a traditional company car scheme. If the correct fleet profile is present, which can broadly be defined as high levels of business mileage and a low cost of car provision, potential employer savings could be significant. However, it is critical to be aware that where an ECOS is operated and the correct fleet profile is not present, it can potentially cost significantly more than a traditional, well designed, company car scheme.

When it comes to the implementation and operation of an ECOS it is likely to be much more complex than a traditional company car scheme for a number of reasons. This may include:

- the fact that an employee will sign a contract to take ownership of the car which can involve complications such as credit checks on employees;
- whether the employee wants to own the car their company provides;
- the funding within an ECOS tends to be a mix of AMAP and gross salary and it is important to correctly calculate all of the PAYE and NIC due to ensure HMRC compliance; and
- due to the complexity of ECOS arrangements they can be difficult to communicate to employees leading to greater resources needed for administration.

Let's look at some examples

To help illustrate the financial implications of providing cars using an ECOS, we have two examples showing the cost to the company of providing a car.

Example 1: A high business mileage driver (15,000 business miles)

A company leases a car using contract hire with monthly lease rentals of £325 and maintenance costs of £50 *(both exclusive of VAT)* and with an annual motor insurance cost of £650.

The car has a P11D value of £20,000 and it has a diesel engine with CO_2 emissions of 125g/km giving an appropriate percentage of 21% for the 2014/15 tax year.

The company reimburses for business mileage at the rate of 14p per mile and the employee travels 15,000 business miles in a year.

The annual cost to the business of providing the company car and business mileage reimbursement would be:

Example 1: Table A

Company position (Company car)	**Annual cost**
Car funding cost (rental + maint. + ins. + irrec. VAT)	£5,540
Employer's NI on company car benefit	£580
Business mileage reimbursement paid (at 14ppm)	£2,100
VAT recovery on mileage reimbursement (at 14ppm)	(£350)
Annual company cost	**£7,870**

The financial position for the employee when provided with a company car and paid business mileage reimbursement for the year would be:

Example 1: Table B

Employee position (Company car)	**Annual cost**
Tax on company car benefit (at 40%)	£1,680
Business fuel purchased (55MPG and fuel at £1.36p/l)	£1,686
Business mileage reimbursement received (at 14ppm)	(£2,100)
Annual company cost	**£1,266**

Under an ECOS, the car provided is a private car with all funding costs met by the employee. However, within the ECOS the employee will now receive business mileage reimbursement at HMRC's full AMAP rates and an increased salary in lieu of the company car. The increased salary will be calculated based on the employee's car cost and business mileage to ensure they remain neutral when compared to the company car equivalent.

The financial position for the employee for the year would be:

Example 1: Table C	
Employee position (ECOS car)	**Annual cost**
Private car funding costs(rental + maint. + ins. + VAT)	£6,050
Business fuel purchased (55MPG and fuel at £1.36p/l)	£1,686
Approved Mileage Allowance Payments (AMAPs)	(£5,750)
ECOS allowance (net)	(£720)
Annual employee cost	**£1,266**

The calculation shows that under an ECOS, the employee would be left in the same financial position when compared to the company car.

The cost to the business of paying business mileage reimbursement and an increased salary for the year would be:

Example 1: Table D	
Company funding costs (ECOS)	**Annual cost**
Approved Mileage Allowance Payments (AMAPs)	£5,750
VAT recovery on mileage reimbursement paid (at 14ppm)	(£350)
ECOS allowance (gross payment giving £720 net funding)	£1,241
Employer's NI on gross cash	£171
Total ECOS car cost	**£6,813**

The example shows that when providing the car via an ECOS (£6,813) it delivers an annual saving of £1,057 when compared to funding a company car (£7,870).

Observation

In future tax years the 'Tax on company car benefit' is set to rise as company car tax rates increase. In an ECOS structured to keep an employee neutral compared an equivalent company car, the increases in company car tax rates can enhance the level of financial advantage offered. For example 1, the annual ECOS saving of £1,057 in 2014/15 would rise by 52% to £1,611 by 2017/18 as result of increasing company car tax rates.

Example 2: A low business mileage driver (5,000 business miles)

The example is based on the same calculation inputs as example 1, but in this scenario the employee only travels 5,000 business miles in a year.

The annual cost to the business of providing the company car and business mileage reimbursement would be:

Example 2: Table A	
Company position (Company car)	**Annual cost**
Car funding cost (rental + maint. + ins. + irrec. VAT)	£5,540
Employer's NI on company car benefit	£580
Business mileage reimbursement paid (at 14ppm)	£700
VAT recovery on mileage reimbursement (at 14ppm)	(£117)
Annual company cost	**£6,703**

The financial position for the employee when provided with a company car and paid business mileage reimbursement for the year would be:

Example 2: Table B	
Employee position (Company car)	**Annual cost**
Tax on company car benefit (at 40%)	£1,680
Business fuel purchased (55MPG and fuel at £1.36p/l)	£562
Business mileage reimbursement received (at 14ppm)	(£700)
Annual employee cost	**£1,542**

In line with example 1, the employee will be provided an increased salary to ensure that their position is kept neutral when compared to the company car. However, as a result of the lower levels of business mileage and lower approved payments that can be made the salary requirements are much higher.

The financial position for the employee for the year would be:

Example 2: Table C	
Employee position (ECOS car)	**Annual cost**
Private car funding costs(rental + maint. + ins. + VAT)	£6,050
Business fuel purchased (55MPG and fuel at £1.36p/l)	£562
Approved Mileage Allowance Payments (AMAPs)	(£2,250)
ECOS allowance (net)	(£2,820)
Annual employee cost	**£1,542**

The cost to the business of paying business mileage reimbursement and an increased salary for the year would be:

Example 2: Table D	
Company funding costs (ECOS)	**Annual cost**
Approved Mileage Allowance Payments (AMAPs)	£2,250
VAT recovery on mileage reimbursement paid (at 14ppm)	(£117)
ECOS allowance (gross payment giving £2,820 net funding)	£4,862
Employer's NI on gross cash	£671
Total ECOS car cost	**£7,666**

The example shows that if the car was provided via an ECOS (£7,666) it would cost £963 more for the year than providing the same car as a company car (£6,703).

WHAT ABOUT OFFERING A CASH ALLOWANCE INSTEAD OF A COMPANY CAR?

Offering a company car was once a relatively straight forward and tax efficient way of providing a benefit to employees. However, the changing tax landscape and a desire by some companies to give employees more flexibility has meant the case for providing company cars, especially cars provided as a perk rather than for a business need, became less clear-cut. As an alternative, companies offered employees the choice of a company car or a cash allowance in lieu of the car.

The popularity of providing cash allowances increased following their inception and based on the general consensus from market surveys, a significant number of companies now offer a cash allowance in some form or another. There can be benefits for a company and its employees where cash allowances are provided, however, as with many arrangements care needs to be taken to make sure they are right for the company and provided in a well structured way.

What are the benefits for an employee?

Where employees are provided with the choice of a company car or a cash allowance they have a greater ability to choose a benefits package that suits their needs and lifestyle. They may opt for the cash allowance to fund a car that is not available on the car scheme, or spend less than their full allowance and receive more income. Also, employees using the allowance to fund a car will own it and are free to make choices about how and what they do with it, such as replacing it more or less frequently than the company car they would have been entitled to.

One of the outcomes of changes to company car taxation that encouraged low emission cars is that it also discouraged higher emission cars through higher tax costs. If an employee wants to have a car with higher emissions then funding it as a private car with a cash allowance may be a more cost effective approach. Further increases in company car tax, even for lower emission vehicles, are set to exacerbate this effect. However, a company may want to consider the impact on their Corporate Social Responsibility agenda of being seen to allow or encourage this.

However, employees must balance this freedom of choice with the costs and risks associated with running the car. With a company car, normally the company will cover the running costs of the vehicle, such as servicing, road fund licence and insurance. An employee needs to remember that they will be responsible for these costs and factor them into their financial calculations when choosing a car.

What are the implications for a company offering cash allowances instead of a company car?

The implications for a company providing cash allowances can often be seen as two sides of the same coin. The positive implications for one company can be the negative implications for another. For example, providing a cash allowance should reduce or remove the administrative burden of providing company cars. However, there is a greater risk of the unknown for companies providing cash allowances as they have less control over the cars employees use for business purposes.

In another scenario, a company could introduce cash allowances as an alternative to company cars to try and reduce benefit provision costs. However, if employees opt out of the car scheme this could reduce volume support and manufacturer discounts received on remaining company cars pushing those costs higher which might negate any cost savings from introducing cash allowances. Therefore it is important that a company fully considers all of the issues and makes sure that cash allowances are suitable.

Whether a company introduces cash allowances, or offers a choice between a company car or a cash allowance, the policy on cash allowances should be set by reference to the whole life cost after tax of the company car. This will ensure that the post-tax cost to the company will remain at the same level regardless of whether the employee selects a company car or cash allowance.

How do you determine the level of a cash allowance?

While it is relatively easy to understand how much cash allowances cost a company, the key question becomes where to set the level of the cash allowances they offer to employees. The company should be confident in what they are seeking to achieve at the outset and provide allowances set at a level to deliver this. Will they, for example, be looking to save costs or simply match what is spent on providing company cars? Is the company comfortable that, inevitably, some employees will gain more under cash allowances, while some will lose out?

If cash allowances are offered alongside a company car scheme, with the objective to be cost neutral to the company on a post-tax basis, it is advisable that any company seeking to introduce such a policy should optimise their company car scheme, before they introduce such changes.

These and other equally important issues relating to the design of a cash allowance system need to be addressed, before core questions relating to the cash calculations are addressed, such as:

- Will the cash allowance be calculated to leave the company in a neutral financial position?
- Will the cash allowance be calculated to leave the employee in a neutral financial position?
- Will the same cash allowance be calculated for each grade of employee?
- Where should the cash allowance levels be positioned when compared to those offered by competitors?
- What rate of business mileage reimbursement should be paid to employees receiving a cash allowance?
- If cash allowances are optional, what can be done to stop employees 'cherry picking' the best option for them, which is usually the most costly for the company?
- If an employee chooses a cash allowance, what degree of control will the company try and retain over vehicle selection, etc?

So the simple question of what is the correct level of cash allowance can become quite complex and when you consider the scale of the sums involved and the number of employees this can be an expensive benefit to provide and one where mistakes could be costly.

How can a company reimburse employees for the cost of business miles travelled in their own car?

As with company cars, employees undertaking business mileage on behalf of their employer will generally be entitled to receive reimbursement from the company for the cost of the fuel they have used. However, unlike company cars, where only the cost of fuel is reimbursed, there are other costs to consider with private cars. The reimbursement for employees using their own car for business mileage will be set to cover costs like servicing, insurance, depreciation etc that may be higher as a result of travelling business mileage.

Approved Mileage Allowance Payments

HMRC publish guidance for the rates a company can pay to employees who use their own car for business journeys undertaken. The Approved Mileage Allowance Payments (AMAP) rates set out the maximum amount per mile that may be reimbursed to employees without triggering an income tax or National Insurance charge. The current rates are as follows:

From 2011/12	First 10,000 business miles in the tax year	Each business mile over 10,000 in the tax year
Cars and vans	45p (1)	25p

(1) The 10,000 mile limit does not apply to National Insurance.

Where employees receive no funding to pay for a car i.e. employees without a cash allowance who undertake incidental levels of business mileage, companies will typically reimburse for business mileage at the full AMAP rates. However, where employees receive a cash allowance, companies often reimburse for business mileage below AMAP rates otherwise there is a risk employees will profit on the rate reimbursed and this could encourage unnecessary business mileage.

For example, if an employee is driving a private car with fuel consumption of 50 MPG and a fuel price of 136p/litre (equivalent to £6.18/gallon) each mile travelled would cost approximately only 12p per mile in fuel costs. If the driver were being reimbursed 45p per mile, this would leave 33p per mile to cover the additional cost of servicing, insurance and depreciation resulting from the extra mileage driven. It may be that the additional costs are not 33p and the employee is profiting from the reimbursement they receive for business mileage.

Many companies address this by reimbursing below HMRC's AMAP rates to have greater control over costs while removing the incentive for driving excessive mileage. Using HMRC's Advisory Fuel Rates (AFRs) is a popular alternative as one set of rates is easier to administer and the rate is set at a level designed to cover the cost of fuel used.

What is Mileage Allowance Relief?

If a company reimburses for business mileage below the AMAP rates an employee is entitled to claim tax relief on the difference between what they actually received and what they were entitled to based on HMRC's allowed rates. This is known as the Mileage Allowance Relief (MAR) and depending on the level of business mileage driven, this can equate to a significant amount for an employee.

For example, if an employee drives 6,000 business miles per year they are entitled to AMAPs of 45p per mile which equates to a total approved amount of £2,700. If the reimbursement rate received was actually 14p per mile they would only receive £840, a shortfall of £1,860 compared to what they can claim tax relief on. The employee can therefore claim tax relief at the end of the tax year for this amount and assuming a 40% tax payer, the relief would be worth an additional £744 (£1,860 X 40% = £744).

In order to claim MAR from HMRC the employee will have to provide sufficient proof to demonstrate the number of business miles driven, the amount of reimbursement received and the value of any MAR due. There are a number of way in which an employee can claim MAR which includes submission of the required information on their self assessment return, use of a Form P87, or even requesting that HMRC reflect MAR in their personal tax code.

Let's look at some examples

To help illustrate the implications of providing cash allowances to employees, we have detailed below some examples showing the cost to the company and the financial position for the employee where cash allowances are provided.

Example 1: An employee who is a basic rate tax payer travels 10,000 business miles each year

The table below shows the cost for a company of providing a Ford Focus to an employee, both as a company car or as a private car funded using a cash allowance.

The employee would be travelling 10,000 business miles per year and reimbursed at HMRC's Advisory Fuel Rates for company cars in both scenarios.

	Company car	Company neutral (a)	Employee neutral (b)	Difference (b-a)
Funding cost to the company	£4,497	£4,497	£5,482	£985
Gross cash allowance provided	–	£4,082	£5,168	£1,086

The cost to the company of providing the company car or a company neutral cash allowance would be £4,497 per annum. This would equate to a gross annual cash allowance for the employee of £4,082.

In order to leave the employee in a neutral position (i.e. no better or worse off than they were in the company car) the gross cash allowance needed would be £5,168. The annual cost to the company of providing the employee neutral cash allowance would be £5,482, an increase of £985 when compared to the cost of providing the company car.

It is important to note that the figures above assume that the employee also makes a full claim to HMRC for the MAR relief. If the employee fails to do this, which many do, the employee neutral annual cash allowance required would be £6,139. The annual cost to the company of providing the employee neutral cash allowance would be £6,361, an increase of £1,865 when compared to the cost of providing the company car.

Example 2: An employee who is a higher rate tax payer travels 5,000 business miles each year

The table below shows the cost for a company of providing an Audi A4 to an employee, covering 5,000 business miles per year.

	Company car	Company neutral (a)	Employee neutral (b)	Difference (b-a)
Funding cost to the company	£6,581	£6,581	£,7295	£714
Gross cash allowance provided	–	£6,235	£7,022	£788

The cost to the company of providing the company car or a company neutral cash allowance would be £6,581 per annum. This would equate to a gross annual cash allowance for the employee of £6,235.

In order to leave the employee in a neutral position (i.e. no better or worse off than they were in the company car) the gross cash allowance needed would be £7,022. The annual cost to the company of providing the employee neutral cash allowance would be £7,295, an increase of £714 when compared to the cost of providing the company car.

It is important to note that the figures above assume that the employee also makes a full claim to HMRC for the MAR relief. If the employee fails to do this, which many do, the employee neutral annual cash allowance required would be £9,160. The annual cost to the company of providing the employee neutral cash allowance would be £9,233, an increase of £2,652 when compared to the cost of providing the company car.

What is an optimised cash allowance arrangement?

An alternative funding option for a company providing cash allowances to employees is an optimised cash allowance arrangement. These arrangements can be implemented by a business where it's employees receive a cash allowance and undertake business mileage in their own car where the business mileage reimbursement rates for these employees are below HMRC's Approved Mileage Allowance Payment (AMAP) rates.

An optimised cash allowance arrangement restructures the way in which the cash allowance and reimbursement for business mileage are provided to employees. The objective of implementing an optimised cash allowance arrangement is typically to deliver a cost reduction for the company and depending on the way it is structured, it can also benefit employees.

How does an optimised cash allowance arrangement work?

A cash allowance paid to an employee is treated as earnings and therefore the value of the cash allowance attracts a tax and Class 1 employer and employee National Insurance Contribution (NIC) charge. In contrast, an AMAP paid to an employee in respect of allowable business mileage in a private car, will not trigger a tax or NIC charge. In essence, an optimised cash allowance arrangement works by restructuring payments made to an employee to replace the cash allowance paid with AMAPs where there is the opportunity to do so.

Taking a simple example of an employee paid a cash allowance of £1, and who is reimbursed 14p for travelling 1 business mile, we can demonstrate at a high level how payments would be restructured in an optimised cash allowance arrangement. In this example, the maximum AMAP rate the employee could have received as reimbursement for travelling 1 business mile is 45p, which leaves an additional 31p that could have been paid without triggering a tax or NIC charge. In an optimised cash allowance arrangement the payments would be restructured so that some of the £1 cash allowance would be replaced with the 31p AMAP, thus reducing the amount paid to the employee which is liable to tax and NICs.

While the mechanics of an optimised cash allowance arrangement are relatively easy to understand at a high level, there is some complexity involved with implementing and operating this type of arrangement. For example, it is necessary to restructure each individual employee's payments based on their individual cash allowance and business mileage claims. Also, the calculations to restructure payments need to be done on an earnings period basis in order to remain compliant with National Insurance legislation. However, most optimised cash allowance arrangements will be implemented with the support of a technology solution to minimise any administration and mange potential compliance risk.

What type of optimised cash allowance arrangements are available?

Typically, optimised car allowance arrangements are either implemented on a 'gross equalised' or a 'net equalised basis'. Under a gross equalised arrangement, the employee receives restructured cash allowance and AMAPs that are equal to the gross payments they would have received in a traditional car allowance arrangement. Under a net equalised arrangement, the employee will receive a restructured cash allowance and AMAPs that will provide the same net income they would have received in a traditional car allowance arrangement. The key features of the two types of optimised cash allowance arrangement are:

- The potential cost reduction for employers offered by net equalised arrangements is typically higher than in gross equalised arrangements (this is because the employer retains the financial benefit of reduced employee Class 1 NICs).
- In a gross equalised arrangement employees can receive a financial advantage as a result of reduced employee Class 1 NICs, whereas this is retained by the employer in a net equalised arrangement.

- Both gross and net equalised arrangements will ensure employees receive the full value of any Mileage Allowance Relief (MAR) they are entitled to through payroll which can reduce employee administration. Where employees have not claimed MAR this can result in an increase in take home pay.
- Due to the complexity of the calculations involved with a net equalised arrangement, it is likely to be much more complex to communicate to employees than a gross equalised arrangement.
- Under a net equalised arrangement it is unlikely an employee will be able to reconcile the optimised cash allowance payments that appear on their payslip without additional information which would have to be provided on a cumulative basis for the tax year in question. Under a gross equalised arrangement it is relatively simple for an employee to reconcile the financial impact of the arrangement using only the information provided on their payslip.
- Following the outcome of a high profile tax case, there is a potential compliance risk for arrangements that are not easily understood by participating employees. The outcome of the case highlighted a need for employers to ensure that arrangements are transparent and clearly communicated to employees. This is especially important where an employer retains any the financial benefit resulting from reduced employee Class 1 NICs. Due to the level of complexity involved, and the fact the employer retains the financial benefit of reduced employee Class 1 NICs, there is a greater level of compliance and possible reputational risk associated with net equalised arrangements.

Let’s look at some examples

Example 1: Fixed cash allowance

An employee who is a higher rate tax payer receives an annual cash allowance of £4,800. The employee undertakes 5,000 business miles and is reimbursed for business mileage at 12p per mile.

The table below shows the cost for a company of providing the cash allowance and business mileage reimbursement.

Example 1: Table A

Company position (fixed cash allowance)	**Annual cost**
Gross cash allowance paid	£4,800
Class 1 NIC on cash allowance paid	£662
Business mileage reimbursement paid (at 12ppm)	£600
VAT recovery on mileage reimbursement paid (at 12ppm)	(£100)
Annual company cost	**£5,962**

The table below shows the net income received by the employee from the cash allowance and business mileage reimbursement provided, along with the value of Mileage Allowance Relief (MAR) the employee would be entitled to claim from HMRC.

Example 1: Table B

Employee position (fixed cash allowance)	**Annual cost**
Net cash allowance received (£4,800 less 40% tax & 2% NI)	£2,784
Business mileage reimbursement received (at 12ppm)	£600
Mileage allowance relief	£660
Annual employee income (net)	**£4,044**

Example 2: Optimised cash allowance – gross equalised

In this example, the employee from example 1 receives the same cash allowance, however, it is provided as an optimised cash allowance on a gross equalised basis.

The table below shows the cost for a company of providing the cash allowance and business mileage reimbursement.

Example 2: Table A	
Company position (gross equalised cash allowance)	**Annual cost**
Gross cash allowance paid	£3,150
Class 1 NIC on cash allowance paid	£435
Business mileage reimbursement paid (at 45ppm)	£2,250
VAT recovery on mileage reimbursement paid (at 12ppm)	(£100)
Annual company cost	**£5,735**

The table below shows the net income received by the employee from the cash allowance and business mileage reimbursement provided. The employee is no longer entitled to receive any MAR as they have been reimbursed at the maximum rate approved by HMRC.

Example 2: Table B	
Employee position (gross equalised cash allowance)	**Annual cost**
Net cash allowance received (£3,150 less 40% tax & 2% NI)	£1,827
Business mileage reimbursement received (at 45ppm)	£2,250
Mileage allowance relief	£0
Annual employee income (net)	**£4,077**

Observation

The tables show that compared to example 1, the cost to the company of providing a cash allowance and business mileage reimbursement falls by £227 as a result of optimising the payments made on a gross equalised basis. The employee also receives a benefit as the net income they receive increases by £33. It is important to note that the employee position in example 1 assumes a MAR claim was submitted to HMRC. If this was not the case the employee's net income would increase by £693 as a result of receiving an optimised cash allowance.

Example 3: Optimised cash allowance – net equalised

In this example, the employee from example 1 receives the same cash allowance, however, it is provided as an optimised cash allowance on a net equalised basis.

The table below shows the cost for a company of providing the cash allowance and business mileage reimbursement.

Example 3: Table A	
Company position (net equalised cash allowance)	**Annual cost**
Gross cash allowance paid	£3,093
Class 1 NIC on cash allowance paid	£427
Business mileage reimbursement paid (at 45ppm)	£2,250
VAT recovery on mileage reimbursement paid (at 12ppm)	(£100)
Annual company cost	**£5,670**

The table below shows the net income received by the employee from the cash allowance and business mileage reimbursement provided. The employee is no longer entitled to receive any MAR as they have been reimbursed at the maximum rate approved by HMRC.

Example 3: Table B	
Employee position (net equalised cash allowance)	**Annual cost**
Net cash allowance received (£3,093 less 40% tax & 2% NI)	£1,794
Business mileage reimbursement received (at 45ppm)	£2,250
Mileage allowance relief	£0
Annual employee income (net)	**£4,044**

Observation

The tables show that compared to example 1, the cost to the company of providing a cash allowance and business mileage reimbursement falls by £292 as a result of optimising the payments made on a net equalised basis. In this example the employee receives no financial advantage as a result of receiving an optimised cash allowance as it is provided on a net equalised basis. It is important to note that the employee position in example 1 assumes a MAR claim was submitted to HMRC. If this was not the case the employee's net income would increase by £660 as a result of receiving an optimised cash allowance.

What non-financial factors should also be examined when providing cash allowances?

A company needs to consider other non-financial factors when moving from a company car scheme to a cash allowance scheme.

Corporate image

Giving employees the freedom to spend money on their choice of vehicle is great, but what boundaries need to be set? For example, if an employee arrives at work driving a new, two-seater sports car, this raises questions as to what message this sends out to company clients when they visit them. The correct image is important to a company and a car that sends an inappropriate message is not helpful in this regard.

Corporate risk

Replacing a company car with a cash allowance relieves the company of the ability to control such things as maintenance, insurance and MOTs. These instead become the responsibility of the employee. However, many companies are battling with how to deal with what is sometimes referred to as the "grey fleet" and corporate manslaughter legislation which contains some very severe ramifications for companies that are not ensuring employees are properly insuring and maintaining private vehicles used for business purposes.

Car scheme policy and administration

The above two issues highlight areas where a company would have to issue guidelines and become involved in administrative matters.

In the example regarding corporate image, it may be necessary to issue guidelines for all cars (e.g. all cars must have 4 doors, or the boot must be large enough to carry standard company equipment). It will become someone's responsibility to check that an employee's choice of car conforms to these criteria prior to approval.

In the example on corporate risk, it may be necessary to introduce a system whereby copies of a driver's insurance, MOT and VED certificates are all recorded. Again, it will become someone's responsibility to monitor this system, record all the information and chase drivers when certificates held on file are out of date.

Companies may be ill-prepared to deal with these new administrative tasks and may not have the appropriate systems in place to deal with them. Inevitably, this would lead to an increased level of administration. The introduction of such systems may not suit every organisation but they are an integral part of introducing a cash allowance scheme.

What other considerations are there when providing cash allowances?

When examining the provision of cash allowances there are further considerations worth bearing in mind. These include:

Q) Is it possible to reclaim VAT on reimbursement paid for business mileage?

A) A company can reclaim VAT on the reimbursement paid to employees travelling business mileage in a private car. However, if the company reimburses at a rate in excess of the equivalent AFR then the VAT is typically capped at the level of AFRs.

Q) What happens if a company reimburses employees for private mileage?

A) If an employee is reimbursed for the cost of private fuel used in a private car the impact on the company and employee is quite different to that in a company car as there is no fixed private fuel scale charge and the cost is related to the amount of fuel used.

The employee will pay tax on the value of the fuel used and this will generally be reported to HMRC on the Form P11D at the end of the year.

The company will pay for the private fuel purchased, any applicable VAT and employer's NI based on the value of the private fuel used.

Q) What happens if an employee has not claimed Mileage Allowance Relief (MAR)?

A) If employees have not previously made a claim for any MAR in respect of business mileage they have undertaken in a private car they may be able to claim relief going back up to six years, subject to having the required supporting documentation.

WHAT IS SALARY SACRIFICE FOR COMPANY CARS?

Salary sacrifice is a contractual arrangement where an employee gives up the right to receive part of their salary, usually in return for their employer's agreement to provide some form of benefit. The concept of salary sacrifice is an integral part of many flexible benefits packages offered by companies to their employees.

Over the last few years the provision of a company car as part of a salary sacrifice arrangement has become increasingly popular. Typically, salary sacrifice for company cars allows the employee to receive a fully financed, maintained and insured company car funded by a sacrifice of salary.

Why is salary sacrifice for company cars attractive?

The marginal rate of income tax for employees is 20%, 40% or 45%. In addition, employee's NIC is between 2% and 12%. Therefore, the income tax and NIC paid on salary can be quite high.

In contrast, the company car benefit percentage is currently a maximum of 35% of the P11D value of the car (although this will increase to a maximum of 37% from 2015/16) with many low emission cars attracting a percentage rate of 5%-14%.

It can therefore be financially advantageous for an employee to replace one form of income (gross salary) with another (a company car) when the company car tax liability is lower than the tax liability on the salary.

What are the benefits of offering company cars via salary sacrifice?

One of the main benefits for a company implementing salary sacrifice is the positive impact that offering a more flexible and engaging benefits package can have on recruitment and retention. A salary sacrifice arrangement can also tap into the company's corporate buying power which, when combined with the selection of a low emission car, allows the provision of a new company car at a much lower cost than the employee funding the same car privately.

Sacrificing salary for a company car can provide the greatest savings where the company car benefit tax charge is low. This means cars with low CO_2 emissions are popular in these arrangements. This can have a measurable impact on the carbon footprint of employees where older private cars that typically have higher CO_2 emissions are replaced with newer low emission cars with greater fuel efficiency.

A concern for some companies is how to deal with “grey fleet” issues where employees undertake business travel in a privately owned car. Cars that fall within this category are termed ‘grey’ because it is often unclear as to where responsibilities lie for such matters as insurance and maintenance. Where employees are moving to company cars provided via salary sacrifice, the company will have greater visibility – and hence control – over these, and other, vital issues connected with running the car.

Let's look at some examples

To help illustrate the potential benefit for employees we have included some examples that show the monthly cost of opting for a company car via salary sacrifice arrangement and the cost of the same car if it was funded privately.

The examples below compare the monthly cost of a car via salary sacrifice to one provided through a fully maintained and insured personal lease with the same payment profile.

In all scenarios, the employee would be better off opting for a car via salary sacrifice when compared to funding the same car privately.

	AUDI A1 3Dr 1.2T SE	FORD FIESTA 3DR 1.0T 125 TITNM	SEAT IBIZA 5DR 1.4 SE	VAUXHALL CORSA 5DR 1.3D 75 SE	VOLKSWAGEN GOLF 3DR 1.6TDi BLUEMTN	VOLKSWAGEN UP 5DR 1.0BMT MOVE UP
Gross salary sacrifice	£339	£299	£343	£343	£400	£276
Net cost of sacrifice (at 40%)	£197	£174	£199	£199	£232	£160
Tax on car benefit (at 40%)	£84	£71	£94	£105	£49	£47
Net cost of car to employee	£281	£245	£293	£304	£281	£207
Private lease cost	£403	£358	£381	£397	£481	£329
Employee saving	£122	£113	£88	£93	£200	£122

How do HMRC deal with salary sacrifice arrangements?

The concept of salary sacrifice has been around for many years and is used successfully to deliver a wide range of benefits that includes cars, pensions, bikes to work, parking, childcare and more. HMRC will want to review the arrangements companies put in place to ensure that everything is implemented in a correct and compliant manner.

The approach requested by HMRC is that once a salary sacrifice arrangement is in place, a company can ask the HMRC Clearances Team to confirm its tax and NIC implications. HMRC state that they will not comment on a proposed salary sacrifice arrangement before it has been put in place. To manage the impact of this, companies will typically seek HMRC clearance once the scheme has been implemented.

It is important to note that the review by HMRC will be on a scheme case-by-case basis and it is not possible to get a blanket approval for an "off the shelf" scheme that a leasing company may be able to provide.

What other considerations are there for salary sacrifice?

When examining the salary sacrifice for company cars there are further considerations worth bearing in mind. These include:

Q) Will salary sacrifice work for all companies?

A) While salary sacrifice can offer a wide range of benefits it is important for companies to consider their objectives alongside the motivations and profile of their employees to make sure it is the right fit. For example, if employees do not attach much value on access to a new car or they change employment quite frequently then salary sacrifice may not be right. However, there are often different employee populations within a company and whilst it may not be attractive for some it could be a good fit for others.

Q) How will announcements made in the 2014 Budget affect salary sacrifice?

A) The change in company car tax rules announced are likely to increase the company car tax cost applicable for employees participating in a salary sacrifice arrangement. However, reductions in CO_2 emissions for cars may counteract the impact of the changes as they occur, leaving salary sacrifice in a similar position to the current state of play.

Q) Does salary sacrifice for company cars generate a saving for the company?

A) A salary sacrifice for company cars arrangement can be structured to generate a saving for a company if required. However, it is important to ensure that the sacrifice for the employee remains at a level such that it offers a commercial advantage when compared to a private car otherwise the level of take up from employees could be impacted.

The rates of Class 1 NIC (employer and employee) will rise from April 2016 in relation to employees in a Contracted-Out Salary Related pension scheme. This may have an impact on the potential employer and employee savings offered by a salary sacrifice arrangement. Therefore, businesses may wish to consider advice to understand the potential impact of this change in the context of their own specific circumstances.

Q) Can a traditional company car scheme run alongside salary sacrifice?

A) Underpinning a salary sacrifice for company cars scheme is the provision of company cars in much the same ways as a traditional company car fleet (i.e. generally they are provided via a corporate contract hire arrangement) and so there is no reason that a company cannot run both types of arrangement.

A number of companies have implemented salary sacrifice arrangements to complement their existing company car fleet, while others have used it to replace their current offering. The benefits and considerations of this decision should be covered as part of a feasibility study or scheme design stage of implementation.

Q) What are the risks to the company from implementing salary sacrifice for company cars?

A) Implementing any salary sacrifice arrangement requires careful thought and consideration to ensure that it is being done in an HMRC compliant manner.

Also, it is important to ensure that the arrangement is designed and implemented in a way that will see strong levels of employee take up.

If an arrangement is not designed correctly, then concerns such as early termination costs, interaction with internal systems and administering the scheme could result in more operational administration for the company than anticipated. However, a well designed scheme should be able to avoid this.

Q) Does a salary sacrifice arrangement for company cars need to be made available to all employees?

A) Unlike some other benefits typically provided via salary sacrifice, there is no requirement for a company to make a salary sacrifice for company car scheme available to all its employees.

APPENDIX

A diagrammatical representation of forthcoming legislation changes up to and including the 2017/18 tax year.

	2014/15	2015/16	2016/17	2017/18	2018/19
Company car tax	0% Company Car Tax (CCT) rate for zero emission cars	Removal of 0% CCT rate for zero emission cars	Removal of 3% surcharge for diesel engine cars		
	CCT for cars with CO_2 emissions exceeding 75g/km to rise by 1% (starts at 11%)(1)	New CCT band for cars with CO_2 emissions of 0-50g/km with CCT rate set at 5%(1)	CCT for cars with CO_2 emissions of 0-50g/km to rise by 2% to 7%	CCT for cars with CO_2 emissions of 0-50g/km to rise by 2% to 9%	CCT for cars with CO_2 emissions of 0-50g/km to rise by 4% to 13%
		New CCT band for cars with CO_2 emissions of 51-75g/km with CCT rate set at 9%(1)	CCT for cars with CO_2 emissions of 51-75g/km to rise by 2% to 11%	CCT for cars with CO_2 emissions of 51-75g/km to rise by 2% to 13%	CCT for cars with CO_2 emissions of 51-75g/km to rise by 3% to 16%
		CCT for cars with CO_2 emissions exceeding 75g/km to rise by 2% (starts at 13%)(1)	CCT for cars with CO_2 emissions exceeding 75g/km to rise by 2% (starts at 15%)	CCT for cars with CO_2 emissions exceeding 75g/km to rise by 2% (starts at 17%)	CCT for cars with CO_2 emissions exceeding 75g/km to rise by 2% (starts at 19%)
Private fuel benefit	Increase in the private fuel benefit multiplier to £21,700	Private fuel benefit multiplier to increase in line with RPI			
Corporation tax	2% reduction in the main rate of corporation tax, dropping from 23% to 21%	1% reduction in the main rate of corporation tax, dropping from 21% to 20%			
		Reduction in the CO_2 emissions threshold for 100% first year allowances on cars from 95g/km to 75g/km			Removal of 100% first year allowances for cars and zero emission goods vehicles.
		Extension of 100% first year allowances for zero emission goods vehicles until March 2018			

Changes announced in the 2014 Budget

(1) Subject to the 3% diesel surcharge

GLOSSARY

The following are definitions of terms for the purposes of this book.

A

Authorised Mileage Allowance Payments (AMAPs)
The statutory reimbursement rates for employees undertaking business mileage in a private car.

Advisory Fuel Rates (AFRs)
The rates published by HMRC for reimbursement for employees undertaking business mileage in a company car. If the rate paid per mile of business travel is no higher than the advisory rate for the particular engine size and fuel type of the car, HMRC will accept that there is no taxable profit and no Class 1 NICs liability.

B

Balloon
A large final payment under a financing agreement that is normally set in-line with the forecast residual value of the car.

Business mileage
A journey that the employee is obliged to undertake in the performance of their duties. Home to a permanent place of work travel is not deemed business mileage.

C

Capital Allowance
A means of obtaining a tax relief for the depreciation of an asset spread over a number of years.

Capital contribution
A capital sum an employee contributes towards the expenditure on the provision of a company car or qualifying accessory. The amount of the contribution is deducted from the list price when calculating the income tax due on the Benefit in Kind.

Car fuel benefit
The reportable value of fuel provided for private use in a company car.

Company car benefit
The amount chargeable to tax on an individual for a company car in a tax year.

Contract hire
The leasing of a car for a fixed monthly cost over a pre-agreed contract term and mileage. The car is returned to the owner (the fleet provider) at the end of the contract term. The agreement may include the provision of services such as maintenance.

Contract purchase
A deferred purchase agreement normally with a balloon payment. The agreement may include the provision of services such as maintenance.

Contributions for private use
The amount an employee is required to pay as a condition of the car being available for private use. The amount of the contribution is deducted from the company car benefit for the year in which payments were made.

D

Depreciation
The loss in value between the purchase price and sale value of a car. This may differ from the depreciation for tax or accounting purposes.

F

Finance lease
Generally a lease that transfers substantially the risks and rewards of ownership of an asset to the lessee. The agreement may include the payment of a balloon payment or may be a fully amortised with no balloon.

Fuel card
A method of payment whereby the business pays for the fuel used by an employee.

Fuel scale charge
The taxable benefit where an employee is provided with free fuel for private use.

H

Hire purchase
A purchase agreement where the title (ownership) does not pass until an option to purchase has been satisfied. This is normally a nominal payment.

L

Lease
An arrangement where the customer has use of goods but does not legally own them.

Lease rental
The payment under a lease agreement.

Lessee
The customer in a lease agreement.

Lessor
The owner of the goods in a lease agreement.

List price
See P11D Value

O

Operating lease
A lease where the risks and rewards of ownership are borne by the lessor. Normally defined as a lease other than a finance lease.

P

P11D Value
The list price of a company car which the company car benefit is based upon.

Personal contract purchase (PCP)
A personal agreement for the purchase of a car by instalments through a finance company. Normally payments will be of equal amounts over the life of the contract except for a larger final payment (often referred to as the balloon payment).

Private mileage
Any mileage that does not constitute business mileage.

R

Rental
See lease rental.

Residual Value
The amount for which a car is sold for at the end of the contract.

T

Tax year
For an individual, the tax year ends on 5 April. Therefore, the 2012/13 tax year runs from 6 April 2012 to 5 April 2013.

V

Value Added Tax (VAT)
VAT is charged on taxable supplies of goods and services.

Vat Fuel Scale Charge
Where a business pays for road fuel on behalf of its employees a method of dealing with the VAT charged on the fuel is to reclaim all of the VAT and pay the appropriate fuel scale charge. This is a way of accounting for output tax on fuel that a business buys but that is then used for private motoring.

W

Whole Life Cost
The post corporation tax cost of funding a company car or cash allowance which includes all commercial costs (such as payments, maintenance, business fuel etc) as well as all direct and indirect tax costs.

Writing Down Allowance (WDA)
The amount of capital allowances that may be claimed in any single year, calculated as a percentage of the car's written down value for which a deduction may be taken in the company's tax computation.

Written down value
The residual tax value of a car in a company's tax computation. It is the original value of the car less the sum of capital allowances given since its purchase.

A FINAL WORD

As our guide has shown, the UK's fleet environment is constantly evolving and against this backdrop of change, what seem like decisions for the future may in fact need careful consideration today. We are confident that the guide's content will help you to identify the key factors that will impact your fleet strategy.

Delivering a fleet policy that both fulfils your company's strategic goals while balancing the competing pressures of risk, cost and benefits is a difficult task. To help you meet that need, LeasePlan Consultancy Services offers industry leading expertise, utilising market leading fleet modelling tools to deliver optimised fleet solutions to our clients – solutions that get the balance right for your unique circumstances.

The assignments we undertake cover the complete range of fleet needs, from relatively simple benchmarking activities through to the design and implementation of complex, multi-funded solutions including structured ECO schemes and Salary Sacrifice arrangements.

Our aim throughout such assignments is to deliver our recommendations in a clear and concise manner. Along with these recommendation we will always include an implementation plan to make it easy for you to begin to act upon the recommendations for your organisation.

Our team can be accessed directly at LPCS@leaseplan.co.uk or via your dedicated LeasePlan Account Director.

Whichever approach you choose, I am confident that the LeasePlan Consultancy team can support your business and deliver a more efficient, better value fleet solution.

With kind regards,

Matthew Walters, Head of Consultancy Services,
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It's easier to leaseplan

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