Round the bend

Don't get driven round the bend by company car decisions. MELISSA MALINS explains the tax implications for owner-managed businesses.

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Down the years there has been much debate as to whether it is more tax-efficient for an employee to take a company car as part of their remuneration package or to purchase their own car. Further, is it better for a company to lease a vehicle or to buy it outright? With many companies offering cash allowances rather than a car itself, coupled with what would seem to be constant changes as to how cars are taxed – both from a personal and a corporate point of view – the question as to which road to follow remains pertinent.

To add to the confusion, the rise in the popularity of financing car purchases by way of a personal contract plan (PCP) puts many people in the same boat as if they were to have a company car (that is, a new car every three to four years).

The tax implications of the decision can be considered from two perspectives:

(1) The owner-manager of a company – the individual is concerned about their own personal tax implications as well as the corporate tax implications for the company.
(2) The employee of a larger corporate – the individual is only concerned about their own personal tax position.

I will not consider the VAT implications because these form a more distinct area and do not affect the method of acquisition for the company.

KEY POINTS

- Increased use of personal contract plans enables many to have a new car every three to four years.
- For the owner manager, there is little advantage in transferring a company tax saving to a personal tax liability.
- A practical example compares the outright purchase of a car with an operating lease.
- Carbon dioxide emissions will determine the tax treatment of company cars.
- A comparison of the relative costs of a company car measured against a cash allowance and personal car purchase.

The owner-manager of a company

In this scenario, the overall tax position needs to be examined carefully. There is little point in making corporation tax savings just to transfer the liability to the owner's personal income tax by way of a company car benefit-in-kind charge.

Let's concentrate first on the method the company will use to 'buy' the car. There are three choices available:

- outright purchase;
- hire purchase arrangement; or
- lease.

OPTIONS

Option	*Accounting*	*Tax treatment*	*Comments*
Outright purchase	Capitalised as PPE	Capital allowances	Rate determined by CO2 emissions
Hire purchase	Capitalised as PPE on normal cash price at time deposit is paid.	Capital allowances and interest payment deductions	Capital allowance rates determined by CO2 emissions
Finance lease	Capitalised as PPE on normal cash price when first instalment is made.	Depreciation and interest payment deductions	
Operating lease	Rentals expensed to the P&L	Deductions for rentals including interest	May be restrictions depending on CO2 emissions.

Notes:
PPE: Property, plant and equipment, ie fixed assets
P&L: Profit and loss account

RANGE OF CARS

Car	*Outright purchase/hire purchase*	*Finance lease*	*Operating lease*
Mitsubishi Outlander 4x4 (electric)	100% FYA	Depreciation at (say) 20%, deduction for interest	Full deduction for rentals
Mercedes Benz C Class (101 g/km)	18% WDA in general pool	Depreciation at (say) 20%, deduction for interest	Full deduction for rentals
Kia Sorrento 4x4 (159 g/km)	8% WDAs in special rate pool	Depreciation at (say) 20%, deduction for interest	Only 85% of rental costs deductible

The ***Options*** table on the previous page outlines the broad tax treatment for each of them, although the devil, as always, is in the detail which will be considered later in this article.

The tax position of a company is probably best illustrated by an example. Let's compare an outright purchase with an operating lease given these are likely to be the two main options.

Drove all Night Limited

Kashif, the owner manager of Drove all Night Limited has decided that he will take a company car and needs to decide how his company should acquire it.

He is unsure as to the type of vehicle he wants so needs to consider a ***Range of Cars*** to ascertain the tax treatment, being mindful that tax effects are determined by carbon dioxide emissions. According to *What Car*, each vehicle to be considered has a list price of about £30,000.

If, in each case, we assume that Drove all Night Limited will retain the car for three years (in the case of the operating lease the duration will be three years) we need to compare and contrast the tax savings over that period. After three years each car retains roughly 43% of its value, about £13,000. See ***Outright Purchase***.

We can transfer these calculations into ***Actual Costs*** for Drove all Night Limited.

OUTRIGHT PURCHASE

	Mitsubishi £	*Mercedes* £	*Kia* £
Cost	30,000	30,000	30,000
Less:WDA (Year 1)	30,000	5,400	2,400
	–	24,600	27,600
Less: WDA (Year 2)		4,428	2,208
		20,172	25,392
Less: WDA (Year 3)		3,630	2,031
		16,542	23,361
Less: Disposal proceeds		13,000	13,000
Pool carried forward		3,542	10,361

ACTUAL COSTS

	Mitsubishi £	*Mercedes* £	*Kia* £
Cost (capital outlay)	30,000	30,000	30,000
Tax effect of capital allowances (factoring in 20% corporation tax rate in Year 1 followed by 19% for Years 2 and 3)	6,000	2,617	1,285
Less: Disposal proceeds	13,000	13,000	13,000
Total costs	11,000	14,383	15,715

Operating lease or contract hire

For the Mitsubishi and the Mercedes, Drove all Night Limited will get full tax relief for the rental payments. For the less fuel-efficient Kia, 85% of them will be eligible for tax relief.

If we assume that each vehicle rental is about £400 a month, the ***Total Costs*** for Drove all Night Limited are as shown below.

The added advantage of going down the operating lease route is that costs such as repairs and road tax will not be the responsibility of Drove all Night Limited.

Although, on the face of it, the operating lease route seems to offer company savings (except in the case of the electric car which is greatly boosted by the 100% enhanced capital allowance) we must also factor in future tax savings outside of the three-year life of the car. If the vehicle has been purchased, capital allowances will continue to be available on the written-down value remaining in the pool.

> ***"If the vehicle has been purchased, capital allowances will continue to be available on the written-down value remaining in the pool."***

In the days of expensive car capital allowance pools (before 2009), balancing allowances would have been available at the end of the three-year period, which would have accelerated the tax savings. Balancing allowances are now less likely given that cars become part of other capital allowance pools and companies will have other items in their general or special rate pools.

TOTAL COSTS

	Mitsubishi and Mercedes £	*Kia* £
Rental costs over three years:	14,400	14,400
Less: Tax relief at 20% for Year 1; 19% Years 2 and 3	2,784	2,367
Total costs	11,616	12,033

PERSONAL TAX IMPLICATIONS

	Mitsubishi £	Mercedes £	Kia £
Car benefit charge per year	2,100	5,100	8,400
Company car tax (assumed 40% taxpayer)	840	2,040	3,360

Whether future capital allowance claims are of use to a company going forward will depend on its tax profile, but they must be factored in. Over time with purchased cars, tax relief will be available on the whole capital outlay.

It's not a one way street

Kashif will also need to consider his own ***Personal Tax Implications*** of taking on a company car. For simplicity, let's assume Kashif is entitled only to the car and not any petrol allowance. A fuel allowance will be considered in the next example when we look at a company car (non-owner managed company) against a cash allowance.

Again, the income tax implications are very much linked to the vehicle's carbon dioxide emissions. I have assumed that the Mercedes and Kia are petrol cars.

The Mitsubishi is looking like a winner all round. Over the three years, an outright purchase would cost Drove all Night Limited about £11,000 (excluding costs such as servicing and road tax) and Kashif's income tax would be £2,520 (£840 x 3) (assuming the tax rates remain unchanged over the three-year period) – a total of £13,520.

This compares with a total of £22,163 for the Kia (£12,083 for the company – down the operating lease route so foregoing future capital allowance savings) and £10,080 (£3,360 x 3) for Kashif.

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National Insurance and sole trading

There will be National Insurance implications for Kashif and his company. Drove all Night Limited will be liable for Class 1A National Insurance on the benefit. This equates to 13.8% of the benefit charge.

As an aside to the above what would be the consequences for Kashif had he decided against incorporating Drove all Night but instead was a sole trader?

The only significant difference to the above calculations would be around the capital allowances. As a sole trader Kashif would have to restrict his capital allowance claim for personal use of his vehicle. This would be instead of being liable to an income tax charge on the benefit of the vehicle.

Going it alone?

Now, let's consider the situation where an employee is only concerned about their own tax liabilities because they are employed by a large corporate organisation and are unconcerned about the company's corporation tax liability.

In this example we will compare overall costs for the employee of taking a company car (with and without fuel provided) with taking a cash equivalent and purchasing their own car on a personal contract purchase (PCP).

Right on Par Limited

Helen is employed by Right on Par Limited and has been offered a mid-range Golf for a company car (emissions 115 g/km; list price £30,000; petrol engine). As an alternative, the company says that it would give her a cash allowance of £5,500 a year. What should she take?

- *Tax on the company car.* With emissions of 115 g/km, Helen, who is a higher rate taxpayer, would have a taxable benefit of £6,000 and so pay tax of £2,400 a year. Further, car fuel is provided. This creates a further taxable benefit of £4,400 and so tax of £1,776.
- *Cash allowance and PCP.* Helen would pay 40% tax on the cash allowance, so £2,200. The rental on the personal contract purchase for the Golf would be about £350 a month, so £4,200 a year. She would also have to pay for servicing, repairs, insurance and petrol. She would also have to pay Class 1 National Insurance of £660 on the cash allowance (£5,500 at 12%).

If Helen incurs significant business travel, while the government qualifying amount for mileage payments is 45p a mile, since she is entitled to a car allowance, Right on Par Limited is likely to only give her a significant reduced rate to cover petrol expenses. The wear and tear on the car, which the 45p is supposed to cover, is deemed to come from her cash allowance.

It would appear that Helen would be far better off accepting the Golf from Right on Par Limited. This is, of course, subject to, dare I say it, non-tax related factors. For an employee who does not need a car or does not need to replace it regularly, the cash would be the better option.

So which road?

As with many situations – and I know it is a cliché – all factors need to be taken into consideration. It's easy to say that going for a low-emission vehicle is the best option but, in reality, many people may not feel comfortable with the constraints of an electric car.

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