momentum

Lex
LOOK AT THINGS DIFFERENTLY

CAPITAL ALLOWANCE AND LEASE RENTAL RESTRICTION

How will the changes affect your fleet operations and costs?

WHITE PAPER

BANK OF SCOTLAND CORPORATE

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What the changes will mean for fleets

The move to emissions-based Capital Allowances and Lease Rental Restriction (formerly Expensive Car Lease Disallowance) announced in the March 2008 Budget is a major change in the fleet industry – the biggest since company car tax was linked to emissions in 2002. But what does it mean for your fleet operations – and your costs? With the legislation due to come into force in April 2009, getting ready for this new regime should be a major focus for organisations with fleets of any size.

These changes in the treatment of Capital Allowances and Lease Rental Restriction are part of a range of Government measures to encourage greener motoring and replace the previous system, which was based on vehicle price. Centred around a threshold of 160g/km CO_2, it means, in essence, that the majority of high CO_2 emitting vehicles will become more expensive to run, irrespective of funding methodology. Although the Lex customer fleet average currently stands at 155g/km CO_2, there will inevitably be potential winners and losers from this new regime. So businesses will need to take action to ensure that the new rules ultimately work to their advantage.

The new scheme has an impact on the attractiveness of leasing vs purchasing – and it simplifies tax administration, as cars are pooled for tax purposes rather than dealt with individually.

Although some of the finer details surrounding the new schemes are yet to be published, this guide aims to demystify the new CO_2-based rules and point out the implications for businesses.

Businesses need to take action to ensure that the new rules ultimately work to their advantage

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Capital allowances and lease rental restriction: then and now

Then: the outgoing scheme

Capital Allowances

The new scheme will replace the 'value-based' regime, where cars with a list price of £12,000 or above are considered 'expensive' and need to be individually identified within corporate tax calculations. Below this value, cars are treated as plant and machinery and included in the general pool.

Cars are written down at 20% (or 25% before 1 April 2008) on a reducing-balance basis, subject to a maximum writing-down allowance (WDA) of £3,000 per annum. (There is an emissions component in the current legislation, in that cars with emissions of 110g/km CO_2 or lower enjoy a first-year allowance of 100%).

Because each car is identified individually, there is a balancing adjustment on disposal, which ensures there is full corporation tax relief for the difference between the purchase price and the sale proceeds. If the tax written down value is higher than the sale proceeds, a balancing allowance is given; and if lower, a balancing charge is incurred. When it is disposed of from the balance sheet, the car is, in effect, removed from the corporation tax calculation.

Lease Rental Restriction

For leased cars, an element of the finance lease cost is disallowed for corporation tax purposes, using the list price above £12,000 as the basis. The percentage disallowance increases as the vehicle list price rises.

Now: the new regime

Capital Allowances

Because the new scheme is based on CO_2 emissions, it includes all cars, not just those above £12,000. There are three categories: cars with emissions above 160g/km CO_2, those with emissions below 161g/km CO_2 and vehicles equal to or less than 110g/km CO_2. In all cases, cars are pooled rather than treated individually.

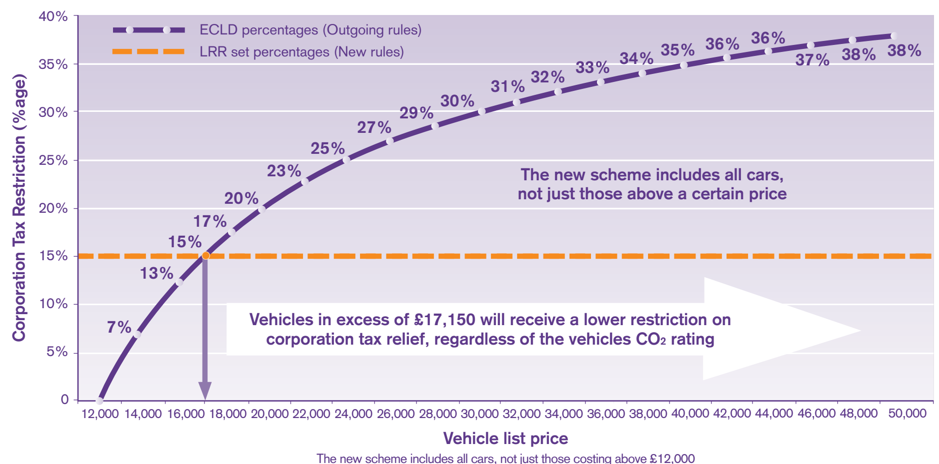
Under the new legislation, cars with emissions above 160g/km CO_2 will be written down at 10% on a reducing-balance basis whilst cars under 161g/km CO_2 will be written down at 20% on a reducing balance basis. The £3,000 pa maximum writing down allowance has been removed. As before, there will be a first-year allowance of 100% for cars emitting 110g/km CO_2 or lower.

When a car is disposed of, proceeds will be deducted from the relevant pool, but there will be no balancing allowance because cars are not separately identified. Each relevant pool will continue to be written down on the same basis each year (i.e. 10% or 20%).
This means that cars in each pool may potentially be written down for tax purposes long after they have been disposed of from the balance sheet.

Lease Rental Restriction

Leased cars with emissions below 161g/km CO_2 will have no element of their leasing cost disallowed for corporation tax purposes, whilst cars with emissions above 160g/km CO_2 will have a flat 15% of the finance rental element of their leasing costs disallowed.

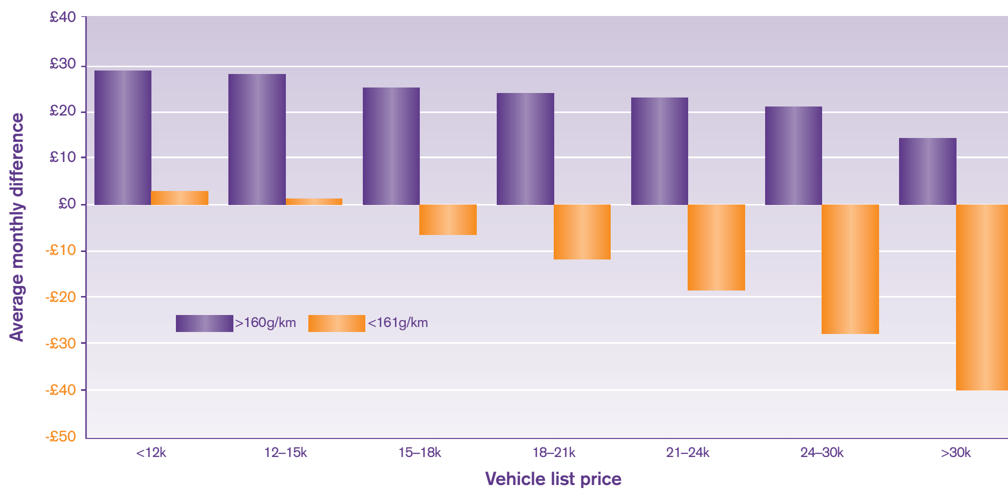
One impact of the new legislation is that the percentage of finance rental costs that are disallowed will be capped at 15%. So as the graph below shows, vehicles with a list price over £17,150 will have a smaller percentage of finance lease payments disallowed.



The new scheme includes all cars, not just those costing above £12,000

Financial implications for fleets

In order to understand how leased vehicle fleets will be impacted from April 2009 it is necessary to consider the list price and CO_2 and the numbers of vehicles in each grouping.



The graph above provides a summary of how certain vehicle categories are likely to be affected. Hardest hit will be cheaper vehicles with a CO_2 of greater than 160g/km whereas more expensive vehicles with CO_2 of 160g/km or less will gain the most.

This graph is based on a selection of common fleet vehicles contracted over 36 months and 60,000 total miles. These cost comparisons also include changes in lease rentals as predicted by the BVRLA (arising due to the changes in capital allowances), changes in the Vehicle Excise Duty (VED) and changes in the lease rental disallowance under the old and new rules. It is important for a company to look at the impact of the change in the lease rental disallowance as well as the changes in the lease rentals and VED as this enables them to see the overall impact on their financial position.

So how will these changes affect you?

It depends on the makeup of your fleet, and whether you lease or purchase.

No fleet will be unaffected by this change. Whilst the Government views it as 'cost neutral', it will clearly only be so if the emissions profile of your fleet is tax-efficient under the new scheme. If you have a fleet whose average emissions are above the 160g/km CO_2 threshold, then from April 2009 you may potentially be paying more corporation tax as a result. (Luckily, manufacturers have cottoned on fast to the rising value of low emissions, so should you wish to 'tune' your fleet, the choice of vehicles in this lower emissions bracket is getting wider).

If you currently buy expensive cars with emissions below 161 g/km it is likely to become cheaper to finance these via leasing – as the lease rental restriction does not apply, and the VAT advantages of leasing come into play.

Where vehicles are currently purchased, the administration of the tax changes will bring some initial complexity – although in the long term, pooling versus accounting for individual cars will simplify the system enormously, which is a major benefit of this new regime. The burden on your tax teams will ultimately lighten considerably under the new rules.

The other effect of this legislation will be to reduce fuel bills and emissions overall, as there is a strong link between CO_2 and fuel consumption (the lower the vehicle CO_2 the better the fuel consumption). Combined with the change in VED (and the high cost of fuel of course), this legislation is driving a move toward more efficient vehicles. This will reduce the fuel cost burden on both employees and companies whilst also contributing to CO_2 emissions reduction targets.

No fleet will be unaffected by this change. Whilst the Government views it as 'cost neutral', it will clearly only be so if the emissions profile of your fleet is tax-efficient under the new scheme

When does it all happen?

It is vital that your fleet policy considers these significant changes now to ensure costs are controlled.

The new emissions-based scheme arrives in April 2009 and will only affect new cars, either when the expenditure occurs, or when the car is made available in the case of LRR. Treasury will be issuing a Technical Note explaining the details soon, with 1st April applying for businesses in the charge to Corporation Tax and the 6th April for businesses in the charge to Income Tax. The new schemes will NOT be applied retrospectively to your fleet and all existing vehicles will continue under the current methodologies until they are disposed of, up to a probable transition period of about 5 years.

The final word

These changes represent a long-awaited overhaul of the corporate tax scheme for company cars. It will simplify administration, particularly for fleets that purchase vehicles outright. This will reduce fuel bills and benefit the environment, by further encouraging a move to lower-emission vehicles. However HMRC must clarify how the transition to the new scheme will work, so that managers can refine their plans.

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About Lex Momentum

Lex Momentum is a strategic consulting team that works with board directors and senior managers to identify how fleet can better impact key business objectives. Our consultancy covers cost reduction, policy, tax, the environment, duty of care and fleet delivery strategy. In addition to core fleet issues, we consult on related areas such as fuel and cash schemes.

Since the team was created in early 2004 we have advised over 250 companies – both clients and non-clients of Lex.

Our consultants have depth and breadth of knowledge in a range of technical areas and have prior experience in major advisory firms or industry. We combine leading edge thinking with the operational experiences that come from being part of Lex, the UK's largest fleet provider.

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