Business Car Taxation – Guide for Limited Companies

Her Majesty's Customs & Excise carry the slogan *'Tax doesn't have to be taxing'*, however, when it comes to the subject of 'Capital Allowances' and business car taxation, many business owners find it difficult to understand what the rules are.

On 1st April 2009, new rules came into force, to encourage businesses to procure vehicles which have a lower 'CO2' emissions rating. Essentially, there will are greater tax advantages to those who procure 'cleaner' vehicles, to those who procure vehicles which have a bigger environmental impact.

The magic number to remember is **160**. Regardless of whether you lease or buy your vehicles, those vehicles which have a certified CO2 rating of under 160g/km will represent greater taxation benefits than those over this limit.

Vehicle Manufacturers have been working on ways to reduce the environmental impact of the vehicles they produce for many years now, and there are now well over 3,000 different models available which fall under this crucial CO2 limit – including some very popular prestige models including *BMW 3-Series* and new *Mercedes E-Class*.

Tip – It's worth noting that when considering a vehicle which has CO2 emissions close to the 160 mark, some manufacture cost options can actually tip the vehicle over the rating, which could prove a costly error. So it's worth checking with your dealer or leasing company before placing your order.

There are different rules which apply, depending on whether you choose to lease or purchase your vehicle.

Buying a Car

If you choose to purchase a vehicle through your business, adding the vehicle to your business assets, then you will be able to deduct a proportion of the cost of the vehicle from your 'taxable profit' and reduce your tax bill. This type of deduction is known as a 'Capital Allowance'.

When you purchase assets for your business, the value of these assets is placed in a 'pool'. The pool they are placed in is dependent on the amount the asset may be 'written down' against your taxable profit – for example, you may have purchased furniture or a computer for your business, and these assets would be placed in a 'Plant and Machinery Pool'.

Under the recent changes to tax legislation, cars which emit less than 160g/km in CO2 can go into a pool with other plant and machinery. In this 'pool', the cost of the vehicle may be 'written down' at 20% per annum.

Vehicles which have a CO2 rating of over 160g/km are placed in a 10% 'pool' with items such as "long-life" assets and "integral" fixtures in building, and it will therefore take much longer to benefit from tax relief on these vehicles.

In both cases, the percentage claimed back will be on a reducing balance basis, so the business will be able to claim less each year as time passes.

However, for vehicles which have a CO2 rating of under 110g/km, businesses can claim 100% of the Capital Cost in the year of acquisition against their taxable profits. This is continuing until at least 2013. ***Note –*** *In order to qualify for 100% tax relief, the vehicle must be unused and not second hand.*

Under the taxation regime prior to April 2009, when the asset was sold, there used to be a 'balancing allowance' – *that is the difference between the sale proceeds and the tax written down value*. So, when a business came to sell the vehicle, the business could claim this balance against their taxable profits.

However, under the new rules, the asset is in a ‘pool’ with lots of other assets, and on the sale of the vehicle, the proceeds are applied to this pool, so this ‘balancing allowance’ rule does not apply. This means that some of the tax relief available is pushed into future years, which means that a business could still be claiming relief on a vehicle long after its been sold.

Practical Examples

New BMW 3-Series 320 Efficient Dynamics 4dr

CO2 Rating of 109 g/km which therefore qualifies for 100% Tax Relief

Purchase Cost of £26,445
Corporation Tax Rate of 28%
Writing down Allowance is 100% in first year, therefore saving ***£7,404.60*** *in tax*

New VW Golf 2.0 GT TDi **140** 5dr

Purchase Cost of £21,335
Corporate Tax Rate of 28%
Writing Down Allowance is 20% per annum on a reducing balance basis

Year 1 – 20% of 21,335 would be £4267.00. So Tax Relief at 28% would be ***£1194.76***
Year 2 – Original Value of £21,335 minus £4267 = £17068. So, in Year 2, 20% relief would be available on this equalling £3413.60. Tax relief would be £955.81 and so on

Crucially, there is no balancing allowance, so the vehicle will continue to be written down at the same rate long after it's been sold.

Tip – The general rule for capital allowances have always been that the expenditure is incurred when there is an ‘unconditional obligation to pay’, providing that it is paid for within 4 months.

Leasing a Car

As with purchasing a vehicle, the amount of lease rentals a business can claim against their taxable profits depends on the CO2 emissions rating of the vehicle.

If the vehicle is under 160g/km CO2 (including those which emit 110g/km or less), then the business may offset 100% of the lease rental payments against their taxable profits.

If the vehicle emits over 161g/km CO2, then there is a 15% restriction on the amount the business can claim against their taxable profits, so just 85% may be recovered.

Practical Example

New VW Golf 2.0 GT TDi 140 5dr

A typical Contract Hire monthly rental on this vehicle would be £279.49 + VAT per month. This equates to £3,353.88 a year.

CO2 Rating on this vehicle is 129g/km, so 100% of the lease rentals may be deducted from a company’s profits. A company paying Corporation Tax at a rate of 28% would therefore be able to save **£1,276.80** on their tax bill.