Tax Update

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Summary of 2009 changes to capital allowances for cars

There will be a number of significant changes to capital allowances for cars with effect from 1 April 2009 for companies (6 April 2009 for the self-employed). Cars acquired after this date will be treated differently according to their certified CO^2 emissions:

- Low emission cars (< 110 gm/km) will benefit from 100% allowance in year of acquisition
- Medium emission cars (between 110 and 160 gm/km): expenditure goes into the general capital allowances pool with a writing down allowance (WDA) of 20%
- High emission cars (> 160 gm/km): expenditure goes into the special rate pool with a WDA of 10%

Although there is currently a 100% allowance for the cleanest cars, other cars are taxed according to their value rather than their emissions, with so-called "expensive" cars (list price over £12,000 – estimated to be over 50% of company cars in the UK) each being allocated to their own individual pool, and having their WDA restricted to a maximum of £3,000 pa. Cheaper cars go in the general pool with a WDA of 20%. No cars qualify for the new Annual Investment Allowance.

In a similar move, payments for leased cars will only be 100% tax deductible if the car's emissions are below 160 gm/km. Otherwise, 15% of the payments will be disallowed.

What does this mean for you?

Tax will not be the only factor to consider when making purchasing decisions, and in difficult economic times, many people will be deferring expenditure in any case. In addition, as is often the case after the Pre-Budget Report, we are awaiting final details of the rules. The government is consulting on the proposed changes until February 2009 even though the changes will come into effect only a few weeks later. But if you have existing cars in your business, or you are considering new purchases in the coming months, here are a few things you might need to know:

Loss of balancing allowance

Most businesses that own cars replace them every three or four years. Under the current rules, although the WDA is restricted to £3,000 pa for expensive cars, when the car is disposed of there is usually a balancing allowance which ensures that all of the net cost (purchase price minus sale proceeds) benefits from tax relief.

Under the proposed rules, cars other than those under 100 gm/km will either be in the 20% pool or the 10% pool. In both cases there will be no balancing allowance on disposal. The time delay in obtaining full tax relief may be significant.

Example

A company wishes to acquire a car for £50,000, with CO^2 emissions of 225 gm/km. It is likely to sell the car after four years by which time the proceeds will be £20,000. If it buys in March 2009, it will receive a capped WDA of £3,000 pa for three years, followed by a balancing allowance in year four of £21,000 on sale. The total cost of £30,000 (purchase price less sale proceeds) will

have been relieved. If it buys in April 2009, it will receive slightly higher WDAs in the first three years of ownership, but with no balancing allowance on sale it will take eight years to relieve the first £20,000 of that £30,000 cost to the business, and a further 20 years to relieve the next £10,000!

Existing cars

If your business already owns cars, and those cars cost less than £12,000, they will stay hidden in the general pool when the rules change, with a WDA of 20% per annum (even if they have high CO^2 emissions). If you are planning to buy a cheaper car with high emissions, you may accelerate tax relief by acquiring the car before April 2009 and keeping it out of the lower 10% pool.

If an existing car cost more than £12,000 and it is currently in its own expensive car pool, it will also stay there after the rules change. It will continue to benefit from a WDA of 20% capped at £3,000 pa, and will benefit from a balancing allowance on disposal, for a transitional period of five years. Businesses planning to acquire expensive high emission cars can avoid the delayed relief brought in by the new rules if they acquire the car before April 2009 and dispose of it before the five year transitional period expires.

Existing expensive cars which are not disposed of in the transitional period will be transferred to the main 20% WDA pool at the end of that period.

Private use

For unincorporated businesses, assets with private use are each given their own pool so that the relevant WDA can be reduced for the element of non-business use. This will continue to be the case with cars under the new regime. The significance of this is that it keeps the asset out of the main pools and on disposal a balancing allowance is still available.

Existing private use assets stay in their own pool and will continue to benefit from 20% WDAs (before the non-business reduction) irrespective of CO^2 emissions.

Lead times

Obviously it can take some time between placing an order for a new car, and that car being delivered and full payment becoming due. The general rule for capital allowances has always been that the expenditure is incurred when there is an unconditional obligation to pay, unless payment is not required within four months, in which case the expenditure is deemed incurred when payment is made.

Generally therefore, if you enter into a contract to purchase a car prior to 1 April (or 6 April for the self-employed) and payment is required within four months, the car will benefit from being treated under the existing and transitional rules.

However, if a car is ordered between now and April, and payment is required within the four months, BUT delivery does not occur until August 2009 or later, the new rules will apply.

Leased cars

Cars under existing leases will remain under the current regime until the lease comes to an end. Cars under leases taken out from April 2009 will be subject to the new 15% disallowance rule where CO^2 emissions exceed 160 gm/km.

Short term hire cars will be subject to the same rules.

Example

Under the current rules, the lease payments for a £25,000 car would have 26% of the payments disallowed. For a £50,000 car, the element disallowed would be 38%. Under the new rules, there will be no disallowance if emissions are below 160gm/km, and only a 15% disallowance if emissions are above this. Leasing will therefore be more attractive than it used to be.

Miscellaneous

It is proposed that cars purchased after the rule changes that do not have approved figures for CO^2 emissions (eg. kit cars) will be deemed to be high emission and will only be entitled to a 10% WDA. It is also proposed that cars purchased under the new regime but first registered prior to 1 March 2001 (and therefore not having CO^2 data at all) will be deemed as medium emission and will be entitled to the 20% WDA.

Motorcycles will be excluded from these new rules altogether, and expenditure on these will simply form part of the normal plant and machinery 20% pool, unless private use of the asset in an unincorporated business requires a separate pool to be created.

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