



Business car taxation – understanding the changes

Effective from April 2009



“In the 2008 Budget the Chancellor set out changes to the current Writing Down Allowance (WDA) and Expensive Car Leasing Disallowance regulations (ECLD). From April 1st 2009 these new regulations will alter the dynamics of the car leasing industry and preparing fleets for the implications of these changes should be a major focus for operators of any company car fleet” Tim Hudson, Commercial Director LeasePlan UK.

This document outlines the changes and illustrates their effect. It also identifies the actions it would be beneficial for businesses to undertake in advance of these changes coming into force in April 2009.



Background to the changes

With transport accounting for 24%* of UK CO₂ emissions it is unsurprising that an environmental focus of HM Government is vehicle emissions. Vehicle excise duty (VED) changes, announced in the 2007 budget, directly linked rates to vehicle CO₂ emissions and car manufacturers have been set a target of reducing average emissions of new cars to 130g/km by 2012. Alongside targets and other governmental measures/initiatives, company vehicle taxation policy is a further lever the Government can utilise in support of its aims.

These latest taxation changes, announced in April 2008, according to the Government now focus on ‘replacing the existing capital allowance treatment for business cars with an emission based approach’. In line with VED, writing down allowances (WDA) and lease rental restriction (formerly known as Expensive Car Leasing Disallowance - ELCD) will now both be linked to CO₂ emission levels.

These changes exclude commercial vehicles, as no formally approved CO₂ emission values are currently published for commercial vehicles. As and when such data becomes a mandatory requirement for light commercial vehicles,

we might reasonably expect to see a similar treatment introduced by government. However, it is more usual for a fleet operator to select a commercial vehicle primarily on its ability to carry out specific business tasks; the tax treatment would be less likely to influence choice of vehicle.

The clear objective is to incentivise business to switch to low emission, more fuel efficient cars. The Energy Saving Trust estimates that British businesses could save £2.6bn** by switching to greener fleets. However in reality this ‘switch’ for business is far from straightforward. An appropriate ‘transition plan’ to take account of these changes will need to include reviewing the existing vehicle fleet & related policy; alongside funding options (purchasing or leasing) against the whole life cost of running a vehicle under this new taxation regime.

* Source: Department for Transport, Carbon Pathways Analysis, July 2008.

** Source: Energy Savings Trust, Behind the Wheel, June 2007.

What is changing?

With effect from April 2009 the capital allowances treatment of all cars will be reformed to favour those with low CO₂ emission, with two key vehicle CO₂ emissions levels established at 110 g/km and 160 g/km. The table below summarises the changes:

	Current (2008-09)	From 2009-10
PURCHASE BASED OPTIONS	<ul style="list-style-type: none"> – 110 g/km secure 100% WDA (to 2013) – 20% WDA (from 25%) general pool (max £ 3000 pa) – Expensive cars (over £ 12k retail Price subject to balancing allowance at disposal point) 	<ul style="list-style-type: none"> – No Change – 20% pool up to 160 g/km – 10% Pool for all over 160 g/km – NO balancing allowances – NO ‘Expensive’ Car – Removal of £ 3000 annual limit
LEASE BASED	<ul style="list-style-type: none"> – ECLD – increasing scale of PERMANENT Rental disallowance applied to ALL cars over £ 12k ‘Retail Price’ 	<ul style="list-style-type: none"> – ECLD ‘scaling’ method ends – No disallowance if 160 g/km or below – 15% disallowance if over 160 g/km
DAILY RENTAL	<ul style="list-style-type: none"> – Not affected 	<ul style="list-style-type: none"> – Subject to same rules as ‘LEASE’ based options

Purchasers of cars will see the most significant change

From 1st April 2009, for companies purchasing vehicles that produce less than 110 g/km of CO₂ there is no change to the 100% WDA. The government has said that, until 2013, it will allow companies to write off the full cost of these cars in the first year.

From 1st April 2009, a redefined 20% WDA pool will apply to ALL vehicles above 110 g/km and up to 160 g/km; a NEW 10% pool will apply to ALL cars over 160 g/km. There will be no maximum WDA of £ 3,000 nor will the expensive car (over £ 12,000 Retail Price) balancing concept operate.

This last element is the most significant in that it defers a purchaser’s opportunity to claim tax relief on any vehicle, irrespective of retail price, until many years after actually disposing of it. Currently a balancing allowance would be secured at disposal time. Consequently, this now makes expensive vehicles OVER 160 g/km much more costly to fund in cash flow terms.

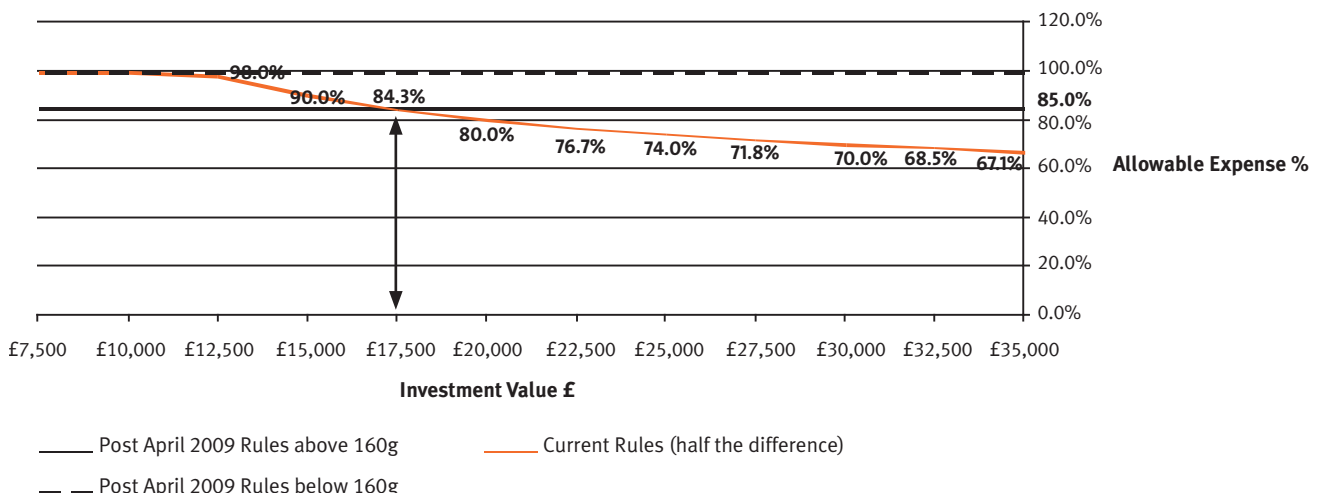
The position in favour of leasing is also effected

Currently any vehicle with a retail price greater than £ 12,000 suffers a PERMANENT disallowance (applied as a % of the Finance portion of the rental) which increases as the price of the vehicle increases. This is known as the Expensive Car Leasing Disallowance (ECLD). From 1st April 2009, the concept of 'expensive car' has been removed and instead we see a Leasing Disallowance linked to the CO2 value of the car. Instead of an increasing disallowance as the cost of the car increased, we see a simple 15% disallowance being applied – irrespective of retail price. This is a welcome change but does mean that any fleet policy must recognise the impact of crossing the 160 g/km threshold on its costs.

The new rules will make it more tax efficient than before to lease a company vehicle that emits 160 g/km of CO2 or less. Additionally as the chart below illustrates cars with a value in excess of a £17,500 become more tax efficient to lease, regardless of their CO2 emissions.

Leasing Disallowance Changes 2009

Allowable Taxable Expense (Finance Element)



What does this mean in practice?

In practice, under the new rules every vehicle will need to be considered on an individual basis to determine how the changes have affected overall cost of ownership. In principle, it will always be beneficial to choose a 160 g/km or below vehicle – irrespective of the method of acquisition.

The contrasting examples below illustrate the impact of both the purchase and lease options under the current and new regimes, expressed as Net Present Values over a 36 month Term. Please note that the costs are purely illustrative.

Example 1

BMW 320	Contract Purchase £ NPV	Contract Hire £ NPV
March 2009	13,100	13,936
April 2009	12,852	12,412

Assumptions:

Vehicle: BMW 320 SE Auto – List Price £ 25,700

CO₂ – 156 g/km

Example 2

Mercedes E220	Contract Purchase £ NPV	Contract Hire £ NPV
March 2009	14,652	15,704
April 2009	15,432	15,385

Assumptions:

Vehicle: Mercedes-Benz E220 CDI Elegance Auto – List Price £ 32,900

CO₂ – 177 g/km

Two very different results arise as a consequence of the CO₂ profile of the two examples:

In the case of Example 1, the BMW is below the 160 g/km threshold & improved costs are attributed to both Purchase and Lease based options. In the case of the purchase option, depreciation is recovered earlier as the £ 3000 maximum WDA has been removed and greater tax relief can be secured in the earlier years. Improvement to Leasing is more marked as historical ECLD of over 25% has been reduced to 0% under the new rules.

As for Example 2, the Mercedes is above the 160 g/km threshold, the purchase option is considerably worsened due to the fact that the vehicle falls into the 10% pool. Interestingly the Lease picture is more positive. Despite the fact that the CO₂ of 177 g/km means that leasing disallowances will continue to be applied, it will be at the much lower rate of 15% rather than over 32% under the old rules.

The conclusion to be drawn from these illustrations is that it is essential to understand the true Whole Life Cost when considering which vehicles should be encouraged onto the fleet and which should be resisted.

Net Present Value - accepted financial accounting method by which the value of money (or an investment) over a period time can be benchmarked. This is important in the examples presented, as purchase and lease based options have very different cash flow profiles.

Whole Life Cost - defined as the entire cost that can be attributed to the vehicle during its ownership cycle, i.e. cost of acquisition/funding, cost of disposal/residual value, maintenance, fuel, insurance and significantly tax/NIC costs that are the responsibility of the company. The examples presented reflect this definition.

Administration

The tax changes will also relieve a major administrative burden from accounting departments, who now only have to worry about whether a vehicle has emissions above or below the threshold to work out their writing down allowance or lease rental restriction. In the case of purchasing, the introduction of a new 10% pool and the removal of balancing allowance tasks. In the case of leasing, either no restriction for cars at or below 160 g/km or a simple restriction of 15% for those above 160 g/km.

When is it changing?

The new tax regime will be applied to all new business cars registered from 1 April 2009. Although the Government has yet to formally confirm how it will affect vehicles acquired before this date it is widely accepted that the 'new' rules will NOT be applied retrospectively to vehicles registered prior to 1st April 2009. Businesses await formal publication of the new rules, including any indications from government of how future tax policy might evolve. We might naturally expect the initial CO₂ threshold of 160 g/km to reduce over time and the new 'pools' to reflect such movements.

What actions should you now take?

As part of an overall transition plan to take account of these taxation changes, there are three key aspects we would strongly advise you consider prior to next April:

Fleet profile & renewals – as a priority, there is a clear benefit in reviewing your current vehicle fleet and assessing the overall financial impact of these changes. As part of this review, it would be sensible to consider appropriate actions to mitigate the overall cost of running the fleet as a consequence of these changes. This will include looking at particular vehicles & drivers, with consideration of whether it would

be appropriate to shorten, or indeed extend, the current replacement cycle. Substantial cost differentials will arise if your vehicle is registered on 31st March 2009 as opposed to 1st April 2009. Employers should ensure they choose the most cost effective replacement point.

Fleet policy – Alongside the VED changes, HM Government have introduced these latest measures as part of a longer term strategic focus on CO₂ emissions. This focus will undoubtedly continue into the foreseeable future. Given the significant financial incentives to do so, it is advisable to ensure that your fleet policy reflects this trend - promoting a 'green approach' to vehicle choice and driving characteristics.

For example, vehicle manufacturers have already responded - there has been a flurry over the last year of both new 'eco-friendly' models and also revisions to engine technology on existing models. In several cases reductions in CO₂ emissions (and fuel consumption) have been achieved with minimal loss in performance. Hence, it would be sensible to review 'choice lists' to ensure that they reflect the best mix of vehicles available on the market today.

Acquisition policy & 'whole life cost' – few operators of car fleets set their vehicle policy & entitlement on the basis of a true whole life cost which incorporates the Tax and NIC components. The changes to tax rules make it even more important to factor such elements into how benefits are delivered to the employee - and costs controlled by the employer. It is essential that you consider now whether you should be looking to change your approach to benchmarking entitlement levels.

Equally, as has been outlined in this document, the financial impact of the method of acquisition has been affected by these changes. Regardless of the general industry view that leasing has been favoured over purchasing as consequence of these changes, we would always advocate assessing the effect at a client level - as part of an overall whole life cost review.

How can LeasePlan help?

We are keen to support our customers understand, interpret & evaluate the effect of these changes in relation to their particular vehicle fleet. Hence, in addition to this publication we are undertaking the following:

- ▶ Briefing all our client account management teams on these changes.
- ▶ Devising a package of consultancy assignments designed to address one or all of the key areas for focus, as identified above. These can be tailored to your particular needs, in respect of how 'in-depth' you may require support. We will announce more details of this initiative at the forthcoming seminars mentioned above.

In summary - key facts to remember

- ▶ Two key vehicle CO₂ emissions levels have been established at 110 g/km and 160 g/km. Vehicle choice, of cars below 160 CO₂, is to be actively encouraged.
- ▶ April 1st 2009 is a key date and substantial cost differentials will arise if a vehicle is registered on or before this date.
- ▶ Correct timing of renewals can positively control costs.
- ▶ Whole life cost assessments of vehicles on fleet, inclusive of Tax, now becomes central to devising an optimum fleet profile.
- ▶ LeasePlan can help assess the optimal approach for clients.
- ▶ LeasePlan can assist in developing a fleet policy which takes maximum advantage of this new tax regime.

LeasePlan Consultancy Services

The LeasePlan Consultancy Services team works with a broad cross section of organisations across all sectors. With specialists in taxation, commercial vehicles, duty of care, environment, outsourcing and policy structure the team delivers bespoke strategic planning and consulting to support the requirements of your business.

We adopt an approach and philosophy we call 'PRISM'

- ▶ PLATFORM Tools to analyse and measure the current situation
- ▶ REASONING Tools to run scenarios and evaluate the impact of proposed solutions
- ▶ INSIGHT Analysis by industry leading experts to guide decision making & recommendations
- ▶ STANDARD Tools to assess quality and service improvement opportunities
- ▶ MEASUREMENT Tools to manage proposed implementations & maintain stakeholders' expectations.

If you would like to learn more about what we can do to support the needs of your business please contact your LeasePlan Account Manager or email us at consultancyservices@leaseplan.co.uk

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