

Company cars and tax



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Company cars are one of the most popular employee benefits. Altogether, more than 1 million UK directors and employees drive company cars. Of these, half receive free fuel for private use.

Successive governments have increased taxation on cars and fuel. Both employers and employees now need to consider the tax implications of company cars before making decisions.

Since April 2002, the system has been reformed to encourage companies to run 'greener' cars. A car's CO₂ emission levels now determine the tax paid for both new and existing vehicles, though older vehicles (registered before 1998) are still taxed on engine size.

This briefing covers:

- How employees and employers are currently taxed on company cars.
- Ways to reduce the tax paid.
- The difference between buying and leasing a car.

1 Employee tax

1.1 Company cars are taxed as a **benefit in kind** for most employees. There are some special cases.

- Employees earning less than £8,500 a year (including the value of any benefits they receive) are not taxed on the benefit. But directors are almost always taxed, regardless of what they earn.
- Pool cars used by more than one employee

for their work are not taxed. A pool car must not normally be kept overnight at an employee's home.

1.2 Employees pay tax at their **top rate**.

- The tax charge is based on an assumed benefit of at least 15 per cent of the car's list price. This minimum applies to the cleanest, most fuel-efficient petrol-driven cars. There are further discounts for cars run on alternative fuels or alternative technology (see **3.3**).
- The assumed benefit increases in 1 per cent stages to a maximum of 35 per cent, depending on the car's CO₂ emissions. The higher the emissions, the higher the assumed benefit (effectively the charge) will be. For example, in 2007/08 the assumed benefit on a car emitting 215gm of CO₂ per

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kilometre (gm/k) is 30 per cent.

Assuming that the list price of the car was £18,000, the tax charge (to a basic rate taxpayer at 22 per cent) would be £1,188 (£18,000 x 30/100 x 22/100).

- Diesel-powered cars attract an extra charge of 3 per cent, unless they are Euro IV compliant and were registered before 2006, subject to the same 35 per cent maximum charge.
- The level of CO₂ emissions at which a particular charge applies may decline annually. The intention is to persuade businesses to buy more fuel-efficient cars. For 2007/08 the minimum has been frozen at 140 gm/k.
- Higher business mileage now has no effect on the tax charge. Nor has the age of the car, except that a special scale charge applies to cars registered before 1998.

1.3 The **list price** is based on the price published by the manufacturer, importer or distributor, plus delivery charges, tax and VAT (but not vehicle excise duty).

- It also includes the list price of accessories (plus fitting and VAT).
- Accessories worth up to £100, fitted after the car has been delivered to the employee, are excluded. So are mobile phones, equipment necessary to a disabled driver, and equipment necessary to the driver to perform his duties.
- The cost of enabling the car to run on compressed natural gas (CNG) or liquid petroleum gas (LPG) is also excluded.

1.4 Employees provided with a **van** pay tax if there is any significant private use.

- Since April 2007, employees are taxed on a benefit of £3,000 (so paying tax of £660 at basic rate of 22 per cent).
- If the only private use is travelling between home and work, employees pay nothing.
- If several employees share the same van, the value of the benefit for each employee is reduced on a just and reasonable basis.

2 Tax on fuel

If any free or subsidised fuel is provided for private use in a company car, the employee is taxed on this benefit. The value of the benefit depends on the fuel efficiency of the engine, not on how much fuel is provided.

2.1 The percentage **charge** for each car is the same as that car's charge for car benefit.

- Cars with higher CO₂ emissions have a higher percentage charge.

2.2 The percentage charge is applied to an **annual figure** for fuel benefit to determine the amount of taxable benefit.

- For 2007/08 the annual figure is £14,400. So for a car emitting 215gm/k, with a percentage charge of 30 per cent, the tax for a basic rate taxpayer would be £950 (£14,400 x 30/100 x 22/100).

2.3 Since April 2007 **van drivers** have been exempted from the fuel benefit charge if the van is used solely for business purposes. If there is any significant private use of the van, drivers are taxed on a benefit of £500.

3 Reducing tax costs

Employees and directors can currently reduce the tax paid on company vehicles in several ways.

3.1 Contribute up to £5,000 towards the cost of buying the car. This decreases the taxable value of the car by the amount contributed.

- You will need to keep the car for several years before you save money. How long depends on the car's size and age, your tax rate and the amount contributed.

In practice, this approach is not particularly tax-efficient. It is of most use to directors or owner managers who want more expensive cars or who want to reduce the amount of capital the business has tied up in cars.

3.2 If you pay the full cost of fuel for private travel, including journeys to and from work, you do not have to pay **private fuel tax**.

For people who only make light private use of a company car there is a strong incentive to pay for their own fuel under the new system. For example:

- For a car emitting 190gm/k, and therefore subject to a 25 per cent charge in 2007/08, a basic rate taxpayer would be paying £792 a year in tax on the fuel benefit, if the employer pays for fuel. If the private fuel they use costs £66 a month or less, they would be better off paying for their petrol.
- A 40 per cent taxpayer driving a car with emissions of 240gm/k giving rise to a 35 per cent charge would have a tax bill of £2,016 in 2007/08 and would have to be using petrol worth almost £168 a month

►Deciding whether to buy or lease a car is a complex issue. See **Car finance** for help in choosing the correct finance package.

“The company car is an important part of many remuneration packages and can provide a powerful incentive for some employees.”
Steve Connor,
Shepley Window Systems Company

to make it worthwhile accepting fuel for private use from the employer.

Paying for only part of the fuel does not reduce the tax paid.

3.3 Using alternative fuels or technology lowers the cost of a company car.

- Battery electric cars attract an extra 6 per cent discount bringing the assumed benefit down to only 9 per cent.
- Hybrid electric/petrol cars attract an extra 3 per cent discount whatever their emissions.
- Since April 2006, cars registered on or after 1 January 2000 which are manufactured to run on liquid petroleum gas or compressed natural gas. attract a 2 per cent discount, whatever their emissions.
- From April 2008, there will be a 2 per cent discount for cars that can use E85 ethanol fuel.

3.4 Second cars are taxed on the same basis as first cars.

3.5 Sharing a car reduces the benefit each employee pays tax on.

- The value of the benefit for each employee is reduced on a just and reasonable basis. For example, if two employees share a company car equally, normally each of them would be taxed on half the usual benefit.
- If the employees are also taxed on fuel

provided for private use, the value of this benefit is reduced in the same way.

3.6 You are only taxed on the **proportion of the year** you use the car.

Tax due on fuel can also be worked out proportionately if you give up the 'free' fuel and so long as the fuel is not reinstated later.

4 No car or your own car?

Some staff will be better off with a company car. It depends on what the company offers.

4.1 Some companies offer employees **extra salary** instead of a company car.

- This is worth considering if the company car has high emissions.

The number of miles you drive on company business no longer reduces the tax charge. But it will affect your running costs.

4.2 Some companies provide benefits for employees who use their **own cars** for business.

- These are normally paid as mileage allowances (see **4.3** or **4.4**). The size of the allowance will be decided by the company.
- Companies may decide to pay the optional passenger rate. The rate is up to 5p a mile for each passenger. The passenger must be an employee who also needs to travel on business.

4.3 Employees who use their own cars usually receive a **mileage allowance**.

- If mileage allowances are paid in line with the HM Revenue & Customs Approved Mileage Allowance Payments (AMAP), there is no tax or NIC liability.
- AMAP for all cars (and vans) are 40p a mile for the first 10,000 miles, and 25p a mile thereafter.
- The rate for employees who use their own motorcycles for business is 24p a mile.

4.4 Employees who do not receive full mileage allowances may claim the balance as **relief** on their tax return (ie on the difference between the AMAP and the amount paid by their employer).

4.5 Employer contributions to the running costs of employees' cars are taxable, unless they are paid as a mileage allowance.

“Owners of small businesses may consider including employees on their personal car insurance. This can provide a cost-effective alternative to a shared company car, though the employee will be taxed on a portion of the premiums.”
Chris Yalland, Toolfix

The tax-free benefits

Though the use of a car and the value of the fuel are taxed, company car drivers do not pay extra tax on some other benefits.

The benefits that escape extra tax are:

- Maintenance and servicing.
- Repairs.
- Insurance.
- Road tax.
- Membership of a motoring organisation.

The cash value of these benefits often outweighs the cost of any car tax paid. Depending on the vehicle and its reliability, the value to the employee will be at least £600 a year, and could be much higher.

Knowing there will be no surprises in the shape of repair bills or insurance increases allows employees to take motoring costs out of the family budget.

- But employees can claim a tax deduction, using AMAP.

5 Tax for employers

5.1 Employers must pay Class 1A **National Insurance contributions** on the taxable value of cars and fuel given to employees.

- The rate of contributions is 12.8 per cent.
- Employers must use the car benefit and fuel scale charges when calculating these contributions.

5.2 The tax due on company cars and private fuel is collected through **PAYE** by an adjustment of the PAYE code.

- You must notify HM Revenue & Customs of any changes in company car use every quarter on form P46 (Car), due on the second day of February, May, August and November.
- There are penalties if you miss the deadlines.

5.3 There are additional rules regarding **VAT**.

- Employers can recover VAT on fuel used for business purposes only. This applies even if an employee pays for the fuel and then claims the cost on expenses.
- Employers who provide fuel for private use at or below cost can recover VAT on the fuel purchase, but must then pay VAT following the set fuel scale charges. From May 2007, these are based on the car's CO₂ emissions. For a three month VAT period, the VAT payable ranges from £27.11 to £63.45. For a three-month VAT return period, the VAT payable ranges from £27.11 for cars emitting less than 140gm/k of CO₂ to £63.45 for cars emitting more than 240gm/k of CO₂.
- Employers do not have to apply the scale charges if they do not recover VAT on the purchase of private fuel.
- Employers do not account for VAT if they charge employees for the use of cars.

6 Buying company cars

6.1 Businesses can claim the cost of purchase through **capital allowances**. This reduces taxable profits and is used by profitable companies with healthy cashflow.

- With conventional cars, all businesses can claim 25 per cent of the written-down cost every year, until the car is no longer in use by the business.

- The maximum that can be written off against tax is £3,000 in one year.
- Businesses can claim 100 per cent first year allowances on the amount they spend on buying low-emission cars for use in the business. Cars must be registered on or after 17 April 2002 and either emit less than 120gm/k of CO₂ or run on electricity.
- Sole traders who buy cars for business and private use can only claim the business portion of the writing-down allowance.

6.2 **Tax relief** is available in full for two items:

- Maintenance and other running costs.
- Interest paid on a loan to buy the car.

6.3 A business cannot recover **VAT** on the purchase of a new car unless it can prove that the car is for business use only.

Typically, car dealers and leasing firms are the only business able to recover VAT.

7 Leasing company cars

7.1 All the **costs of leasing** can be deducted from taxable profits as expenses, unless the car has a retail price of over £12,000.

- A complex formula is used for cars over £12,000. Ask your accountant for advice if you want to lease a higher value car.

7.2 Only 50 per cent of the **VAT** charged on rentals can be claimed, unless the car is used wholly for business purposes only.

7.3 Capital allowances can only be claimed if there is an **option to purchase** the car.

- The allowances are limited to £3,000 per year (see **6.1**).

8 Getting help

8.1 Both employees and employers need **advice** before deciding what to do.

- Consult an accountant for advice.

8.2 **HM Revenue & Customs** provides useful leaflets (www.hmrc.gov.uk/cars):

- Leaflet IR 125 'Using your own car for work' explains how to claim any tax-deductible allowances.
- Leaflet IR 172 'Income tax and company cars' explains how individuals are taxed on company cars.

Expert contributor

Thanks to **Steve Connor** (Shepley Window Systems Company, 0161 214 2400); **Sarah Salton** (Hurst & Company Accountants LLP, 0161 477 2474, www.hurst.co.uk).

Further help

There are other Directors' Briefing titles that can help you. These briefings are referred to in the text by name, such as **Car finance**.

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