Capital allowances for business cars

Who is likely to be affected?

Any business that buys or leases cars.

General description of the measure

The 100 per cent first-year allowance (FYA) for expenditure incurred on cars with low carbon dioxide (CO_2) emissions and electrically propelled cars that is due to end on 31 March 2013 will be extended for an additional two years to 31 March 2015. In line with other FYA schemes, cars acquired for leasing will no longer be eligible for the FYA.

In addition, the measure reduces the emissions thresholds governing the availability of FYAs, the rate at which writing down allowances are available and the restriction of lease rentals.

Policy objective

Focussing capital allowances on a car's CO_2 emissions, by encouraging businesses to choose cleaner cars over more polluting ones, helps ensure that the Government's environmental objective of reducing overall CO_2 emissions by business cars is met.

Background to the measure

The availability of 100 per cent FYAs for expenditure incurred on cars with low CO_2 emissions and electrically propelled cars expires on 31 March 2013. The Government announced its intention to extend the availability of this allowance at Budget 2012. At the same time the Government announced that the qualifying threshold for low CO_2 emissions will be reduced to match EU emissions targets for 2020 and that the threshold for main rate cars will also be reduced, as will the associated lease rental restriction, to match EU emissions targets for 2015.

Although there has been no formal consultation, this policy was designed in discussion with business to keep the overall compliance costs for businesses as low as possible.

Detailed proposal

Operative date

For capital allowances, the measure will have effect for expenditure on cars incurred on or after 1 April 2013.

The change to the lease rental restriction will have effect for leases commencing on or after 1 April 2013 for corporation tax purposes and 6 April 2013 for income tax purposes.

Current law

Business expenditure on plant and machinery normally qualifies for tax relief as capital allowances, which are normally given at the rate of 18 per cent a year on a reducing balance basis. Under current law, section 45D Capital Allowances Act 2001, 100 per cent FYAs are available to businesses that purchase cars with low CO_2 emissions or electrically propelled cars. The allowance is due to end on 31 March 2013.

The capital allowances rules for cars are based on their CO_2 emissions per kilometre driven. Currently, cars that emit:

- 110 grams of CO_2 per kilometre driven (g/km) or less are eligible for a 100 per cent FYA;
- over 110g/km but not more than 160g/km are written down at 18 per cent per annum on the reducing balance basis; and,
- over 160g/km are written down at eight per cent per annum, also on the reducing balance basis.

In addition, where a business hires a car for over 45 days, and does not sub-hire it, it is subject to a lease rental restriction which restricts the amount of car lease rental payments that can be deducted for tax purposes. This restriction disallows 15 per cent of the payments in respect of cars with emissions exceeding 160g/km.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to extend the FYA for two years, to 31 March 2015. In addition, to bring these FYAs in line with other FYAs, expenditure incurred on cars that are to be leased will be excluded from the scope of the relief.

Since the current thresholds were introduced the car fleet has become much cleaner with more cars emitting less than 110g/km and fewer cars emitting more than 160g/km. To ensure that the measure remains properly focussed, the CO_2 emission thresholds which determine the rate at which capital allowances are given, and at which lease rentals will be restricted, will also be revalorised so that cars that emit:

- 95g/km or less are eligible for a 100 per cent FYA;
- over 95g/km but not more than 130g/km are written down at 18 per cent per annum on the reducing balance basis; and,
- over 130g/km are written down at eight per cent per annum, also on the reducing balance basis.

The emissions level applicable for the lease rental restriction will also be reduced with effect from 1 April 2013 to disallow 15 per cent of the payments in respect of cars with emissions exceeding 130g/km.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2012-13</td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td></tr>
<tr><td>-</td><td>+25</td><td>+115</td><td>+185</td><td>+250</td></tr>
<tr><td colspan="5">These figures were set out in Table 2.1 of the Budget 2012 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Budget 2012.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure is expected to encourage higher levels of investment in the most environmentally-friendly business cars.

Since the threshold for the 100 per cent FYA was last revalorised in 2008, the car fleet has become much cleaner with more new cars qualifying for the FYA. Only two per cent of new cars sold in 2008-09 qualified for the FYA whereas 18 per cent of new car sales in 2012-13 qualify at the current threshold.

Similarly there are now far fewer cars emitting more than 160g/km (12 per cent of new car sales) than when this threshold was introduced in 2009 (24 per cent of new cars sold).</td></tr>
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<tr>
<td>Impact on individuals and households</td>
<td>Capital allowances can only be claimed on qualifying expenditure incurred by businesses. Any extension to the FYA regime and amendments to the CO_2 emission thresholds should have no impact on households.

There may be some impact on the self employed who tend to purchase second-hand cars, which can be slightly more polluting than new cars, because technology has moved on since those vehicles were originally made.</td>
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<td>Equalities impacts</td>
<td>The Government does not believe that any revision to the CO_2 emission thresholds will have any adverse equality impact. Although more men than women tend to have company cars, companies will have identical policies as to the types of cars the employees are entitled to.

The self-employed often use cars both for private and domestic purposes and their choice of vehicle will be determined by factors such as age and cost of the vehicles and domestic considerations, not solely tax considerations.

It is claimed that cars provided to or used by the disabled are more polluting because they have to be bigger vehicles to accommodate any special equipment, or are automatic cars, being easier to drive. No issues have however been brought to our attention since the capital allowances treatment of cars has been based on their CO_2 emission thresholds.</td>
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<tr>
<td>Impact on business including civil society organisations</td>
<td>For car manufacturers this measure should increase the demand for lower carbon car models with respect to models that emit higher levels of CO_2.

For those businesses purchasing cars, depending on their individual purchasing decisions, this measure could accelerate or slow the rate at which the costs of car purchases can be deducted against taxable profits. The extension of the FYA is expected to have a negligible impact on administrative burdens for business as the measure extends an existing FYA scheme.

Bringing the FYA in line with other FYAs to exclude leased cars may increase the demand for direct vehicle purchases with respect to leasing. The withdrawal of the FYA from those cars to be leased, whilst impacting on car leasing companies, is expected to have a negligible impact on business as there are no changes to businesses ongoing administrative burdens. Similarly the revalorisation of the CO_2 emissions thresholds is expected to have a negligible impact on businesses.

There is expected to be an impact for business resulting from the lease rental restriction due to the revalorisation of the CO_2 emission thresholds. Businesses may be required to calculate the restriction on more of their car fleet, with the average number of cars affected over the scorecard period expected to be 300,000.

The expected impact is detailed below:

<table>
<tr><td></td><td>Cost</td><td>Time Period (yrs)</td></tr>
<tr><td colspan="3">Compliance Costs</td></tr>
<tr><td>One-off Costs</td><td>Negligible</td><td>N/A</td></tr>
<tr><td>Average Annual Costs</td><td>£550k</td><td>5</td></tr>
<tr><td>Total Costs (PV)</td><td>£2.6m</td><td>5</td></tr>
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<table>
<tr><td colspan="3">Compliance Benefits</td></tr>
<tr><td>One-off Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Average Annual Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Total Benefit (PV)</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Net Benefit (NPV)</td><td>-£2.6m</td><td>5</td></tr>
<tr><td colspan="3">Impact on Administrative Burden (included in Net Benefit)</td></tr>
<tr><td>Increase</td><td>Decrease</td><td>Net Impact</td></tr>
<tr><td>£200k</td><td>£0</td><td>£200k</td></tr>
</table>
(Note: The impact on administrative burden (included in net benefit) represents the expected cost for the first year. The £550,000 included in compliance costs represents the average amount over the five years).
The changes proposed will not affect the writing down treatment of cars that were purchased before the changes takes effect. There may be some transitional costs to business in respect of understanding the new rules however these are expected to be negligible.
The measures are expected to have a negligible impact on civil society organisations. Civil society organisations cannot make claims for capital allowances, although if they lease cars their rentals may be more expensive if they chose to lease more polluting cars.
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<td>Operational impact (£m) (HMRC or other)</td>
<td>There will be a negligible cost to HM Revenue & Customs (HMRC) for updating guidance. The measure will not increase HMRC’s processing or compliance resource needs.</td>
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<td>Other impacts</td>
<td>
<u>Carbon assessment</u>: the measure will have an indirect impact reducing carbon emissions and support the Government’s objectives to reduce greenhouse gas emissions.
<u>Small firms impact test:</u> the impact of this measure on small businesses is not anticipated to differ from that on large businesses.
Other impacts have been considered and none have been identified.
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Monitoring and evaluation

This measure will be kept under review by regular monitoring of cars sales data provided by industry.

Further advice

If you have any questions about this change, please contact Andrew Donaldson on 020 7147 2282 (email: andrew.s.donaldson@hmrc.gsi.gov.uk).

1 Cars with low carbon dioxide emissions

(1) In section 45D of CAA 2001 (first year qualifying expenditure on cars with low carbon dioxide emissions)—
   (a) in subsection (1)(a), for "2013" substitute "2015", and
   (b) in subsection (4), for "110" substitute "95".

(2) In section 46 of that Act (general exclusions), in subsection (5) omit "section 45D".

(3) In section 104AA of that Act (special rate expenditure: meaning of "main rate car"), in subsection (4) for "160" substitute "130".

(4) Accordingly, in section 77 of FA 2008 omit—
   (a) subsection (2), and
   (b) subsection (3).

(5) The amendments made by subsection (1)(b), (2) and (4)(b) have effect in relation to expenditure incurred on or after 1 April 2013.

(6) The amendment made by subsection (3) has effect in relation to expenditure incurred on or after the relevant date.

(7) But in relation to expenditure incurred on the hiring of a car—
   (a) for a period of hire which begins before the relevant date, and
   (b) under a contract entered into before that date,

section 49(1A) of ITTOIA 2005 and section 57(1A) of CTA 2009 apply on or after the relevant date as if the amendment made by subsection (3) did not have effect.

(8) "The relevant date" means—
   (a) in the case of income tax, 6 April 2013, and
   (b) in the case of corporation tax, 1 April 2013.

EXPLANATORY NOTE

CARS WITH LOW CARBON DIOXIDE EMISSIONS

SUMMARY

1. This clause extends the 100 per cent first-year allowance (FYA) for expenditure incurred on cars with low carbon dioxide (CO_2) emissions and electric cars, which is due to expire on 31 March 2013, for an additional two years to 31 March 2015. In addition, the clause reduces the emission thresholds that determine the rates of capital allowances available on cars and the restriction of lease rentals. It also aligns the treatment of cars with other assets provided for leasing by excluding expenditure on cars provided for leasing from qualifying for FYAs.

DETAILS OF THE CLAUSE

2. Subsection (1)(a) extends the period in which FYAs are available on cars with low CO_2 emissions, including electric cars, by two years to 31 March 2015.

3. Subsection (1)(b) reduces the emissions threshold so that only cars emitting no more than 95 grams of CO_2 per kilometre driven qualify for FYAs.

4. Subsection (2) makes a change so that cars provided for leasing no longer qualify for FYAs. It does this by repealing the override contained in section 46(5) Capital Allowances Act 2001 (CAA 2001) to General Exclusion 6 in section 46(2).

5. Subsection (3) amends the definition of a main rate car in section 104AA(4) CAA 2001 to those cars emitting no more than 130 grams of CO_2 per kilometre driven. This means that cars emitting more than that amount only qualify for the special rate of writing down allowances (currently eight per cent per annum) rather than the main rate of writing down allowances (currently 18 per cent per annum). It also means that the lease rental restriction will apply to cars emitting more than 130 grams of CO_2 per kilometre driven.

6. Subsection (4) removes subsections (2) and (3) from section 77 Finance Act 2008 which set the previous emission thresholds.

7. Subsection (7) provides that the revised threshold for the lease rental restriction will only apply to those lease contracts entered into after the date given by subsection (8).

BACKGROUND

8. Capital allowances allow the cost of capital assets to be written off against taxable profits. They take the place of depreciation charged in the commercial accounts, which is not allowed for tax. Most businesses are entitled to an annual 100 per cent allowance, the Annual Investment Allowance (AIA), for their investment in most plant and machinery (excluding cars) up to an annual limit of £25,000. For expenditure above that limit, writing-down allowances (WDA) are available, which are given at the main rate of 18 per cent or the special rate of eight per cent per annum.

9. FYAs, currently available at a rate of 100 per cent, are available for expenditure on certain types of plant or machinery as an alternative to AIA and WDA.

10. Whilst cars are plant and machinery, there are special capital allowances rules that only apply to expenditure incurred on cars.

- Expenditure on electric cars or cars with very low CO_2 emissions (up to 95g/km driven from 1 April 2013) qualify for 100 per cent FYAs. This allowance aims to encourage investment in cleaner cars by providing a tax incentive for businesses to invest in those cars with the lowest CO_2 emissions. It is complemented by wider measures including 100 per cent FYA for expenditure incurred on natural gas and hydrogen refuelling equipment which is also being extended to 31 March 2015.

- Following the changes made by this measure, expenditure on 'main rate cars' (those with CO_2 emissions over the 95g/km threshold for FYA but no more than 130g/km) will be allocated to the main rate pool and qualify for 18 per cent writing down allowances on the reducing balance of expenditure.

- Expenditure on cars with CO_2 emissions exceeding 130 g/km will be allocated to the special rate pool and qualify for eight per cent writing down allowances on the reducing balance of expenditure.

11. In addition, whilst expenditure on the provision of plant or machinery for leasing has been, and continues to be, excluded from being first-year qualifying expenditure this exclusion has not applied to cars with low emissions. This measure aligns the treatment of low emission cars with all other plant and machinery provided for leasing.

12. Some businesses hire or lease their cars rather than buy them. There are rules that restrict the tax deduction for hire expenses where the car has emissions equivalent to those that would be allocated to the special rate pool. This "lease rental restriction" reduces the amount of the rental payments that would otherwise be allowed in calculating a

business's taxable profits by a flat rate disallowance of 15 per cent. For leases commencing on or after 1 April (corporation tax) or 6 April 2013 (income tax) the lease rental restriction will apply to cars over the 130g/km threshold.

13. If you have any questions about this change, or comments on the legislation, please contact Andrew Donaldson on 020 7147 2282 (email: andrew.s.donaldson@hmrc.gsi.gov.uk).