



April 2009
Company Car
Corporate Tax
Changes

A study of their impact on the end user businesses

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Rationale for Study

What is happening with Corporation Tax on Cars?

In April 2008 the Chancellor of the Exchequer announced some changes in the treatment of company cars for corporation tax. Under current rules, depreciation is allowed at 20% of the reducing balance albeit capped at a maximum of £3000 per annum, but when the vehicle is re-sold, a 'balancing allowance' equating to the remainder of the depreciation can be claimed by the owner. Thus the owner can claim **all** depreciation within the lifecycle of the vehicle + one year.

From April 2009 the rules are changing to a system that is tiered according to the vehicle's CO₂ rating. There will be **no balancing allowance** and three separate depreciation pools will now exist as follows: -

Pool Class	Depreciation Amount	Period of Depreciation
Cars emitting 110g/km CO ₂ or less	100%	First Year
Cars emitting between 111g/km CO ₂ and 160g/km CO ₂	20%	Per Annum – reducing balance
Cars emitting more than 160g/km CO ₂	10%	Per Annum – reducing balance

Who will it affect?

These changes will have a profound impact on the owners of the cars (mainly banks and leasing companies) as, in effect, cars emitting more than 110 g/km will never get fully written down. By our calculations it could take 30 years to write down a vehicle to a negligible level.

Certainly, over the first five years of life, the write down will be nowhere near the existing levels and we believe the banks will not be looking much beyond this period in order to calculate their cost of funds. It is inevitable therefore, that the banks and leasing companies will be raising the cost of vehicle funding to reflect this. It is also very unlikely that they will give much notice on this as, not only are they otherwise occupied with the general finance markets, but the changes will not affect cars delivered before April 2009.

Why should we be concerned?

The vehicle leasing industry is a marginal business that is prone to the effects of economic downturn. The most recent example is the fall in used vehicle values resulting to 'losses on sale' in many cases which have a direct impact on the leasing company's bottom line, after all, they bear the risk in most cases.

Where the tax efficiency of vehicle ownership is impacted, you can be sure that the leasing companies will pass on the effects to their clients; they cannot afford not to! What is uncertain at this point is the level of sophistication that they will apply to the exercise. In theory each vehicle is now unique in its tax efficiency, and as the conclusions of this study suggest, the reality of how the industry will address this is as yet unknown.

Is it all bad news?

No it most definitely is not! At the same time as announcing the changes in corporation tax on company cars, the Chancellor announced a simplification to the 'Expensive Car Leasing Disallowance' that currently applies to any leased vehicle with a list price (or fair market price) over £12000.

Currently if a vehicle value exceeds £12000, only half of the difference can be added to the £12000 to calculate the 'allowable rental' for tax purposes. To illustrate: -

Vehicle original value	£20,000
Fully allowable	£12,000
Difference	£8,000
Half of the difference	£4,000
Add half of difference to	£12,000
Equals	£16,000
As a percentage of original value	80%

Thus 80% of the lease rental (financial portion) is tax deductible as a business expense.

In this case the 'Expensive Car Leasing Disallowance' equates to 20%

From April 2009, the 'ECLD' will be a flat rate of 15% for cars emitting over 160g/km CO₂ and will be scrapped for those emitting 160g/km of CO₂ or less. What this means for the end user customer, is that whereas it is inevitable that from April 2009, new vehicle rentals will increase in the majority of cases, some cars will offer a significant improvement in 'lease rental' tax efficiency, mitigating and in some cases surpassing those increases in rental.

Scope of Study

The scope of this study is to analyse the effect of the corporation tax changes on the lessor's ability to write vehicle costs off against tax liabilities and from that to conclude to what magnitude they would need to increase lease rentals to keep them neutral.

At the same time the study addresses the effect of changes to the ECLD from a client's perspective and quantifies what that means in improved cost (in most cases) for the client. The objective is to present the client with a net position after all of the tax changes, in order that they can modify policy to contain costs.

This study does not present current or future 'whole life costs' of cars, it merely illustrates the 'difference' in the 'before April 2009' and 'from April 2009' scenarios. We would however advocate the incorporation of all 'whole life cost' factors in any comprehensive review of policy.

Methodology

Data

In order to create the most accurate picture possible a comprehensive list of 5259 available UK cars was obtained from a well respected UK lease provider. For the avoidance of doubt, the figures supplied reflected all standard discounts and manufacturer support terms that the lease company enjoys as a leading supplier in this market.

Within our study, we have considered four separate sets of replacement parameters, however for the purpose of this report we have used lease quotations based on 4 years and 80,000 miles total, without maintenance provision. (Maintenance is irrelevant to the calculations of tax differentials).

Assumptions

- ❖ All businesses involved are corporation tax payers at 28%.
- ❖ Discount value applied to corporation tax allowances claimed - 10% per annum.
- ❖ Discount value applied to lease rental tax allowances – 5%per annum.

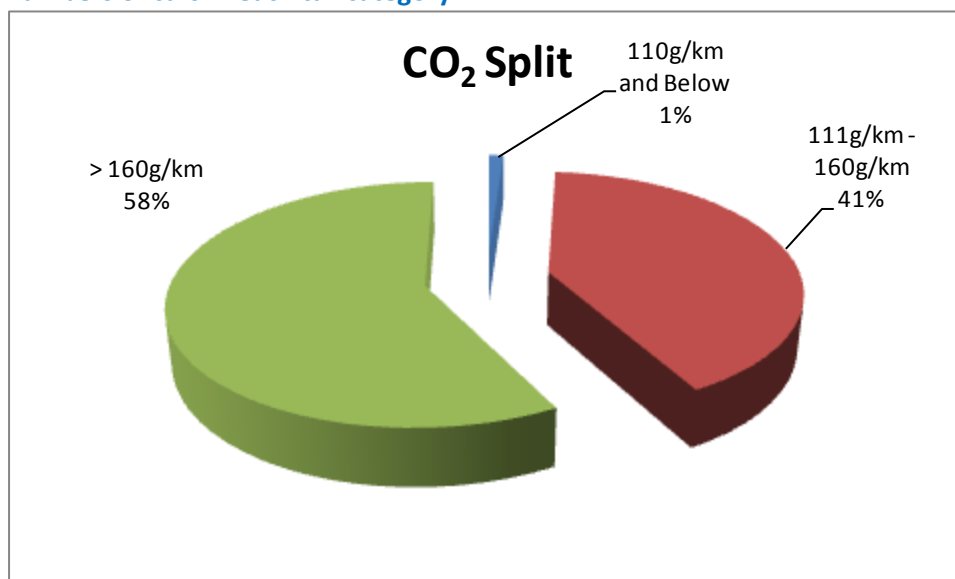
Values

- ❖ All values are expressed as net present values based on the annual discount factors.

Results

Highlights

Numbers of cars in each tax category



Across the board changes

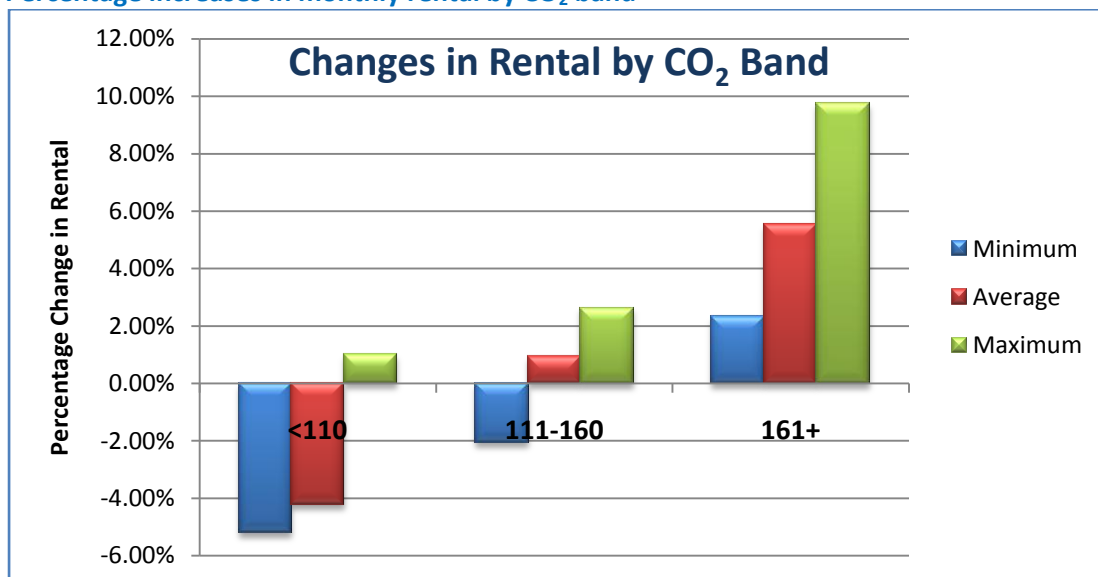
Dynamic	Average Value	Maximum Value	Minimum Value
Increase in rental before Lease Allowances considered overall	£13.68	£70.08	-£17.47
Increase in rental after Lease Allowances considered overall	-£1.96	£22.87	-£146.65
Increase in rental before Lease Allowances considered 111-160g/km	£2.23	£6.25	-£11.77
Increase in rental after Lease Allowances considered 111-160g/km	-£9.44	£3.63	-£59.11
Increase in rental before Lease Allowances considered over 160g/km	£22.20	£70.08	£9.65
Increase in rental after Lease Allowances considered over 160g/km	£3.46	£22.07	-£146.65

Despite the fact that only 58% of cars will suffer the most penal reduction in writing down allowances nearly 94% of cars will increase in rental price under the new rules.

Table of Averages

CO2 Grouping	Average Headline Rental Increase	Average Total After ECLD
110g/km and Below	-£10.72	-£10.15
111g/km - 160g/km	£1.71	-£10.49
> 160g/km	£23.60	£4.09
Grand Total	£14.09	-£2.13

Percentage increases in monthly rental by CO₂ band



Policy Busters!

Clearly, businesses base their car policies on both, historical hierarchy and contemporary costs, so significant and immediate change can send this into complete disarray. Some such changes are illustrated below: -

- ❖ Average Mondeo up £13.17 per month in rental, average S-Max up by £17.95 per month.
- ❖ Average Vectra is up by £20.61 per month and Astra by £11.93.
- ❖ Average Diesel Audi A4 increases by £11.04 per month.
- ❖ BMW 5 Series rentals increase by an average of £23.97 per month
- ❖ Saab 9-3 Diesel up by £11.40 per month and 9-5 up by an average of £26.33 per month

Conclusions

What cars fair best in total cost terms?

Generally it is low emitting more expensive cars with relatively low depreciation that show the greatest improvement over the old scheme, hence we see the BMW range doing pretty well, particularly the diesels.

What are the worst performers under the new rules?

Here generally it is lower value higher polluting cars with poor depreciation that fair worst. The likes of Chevrolet, Dodge, Suzuki, Ssangyong, Daihatsu, Chrysler, Jeep, Subaru and Kia are particularly badly affected followed closely by Saab, Hyundai Cadillac Mitsubishi and Nissan.

So should we avoid these cars and go for BMW's and their like?

We must be mindful of the conclusions here. If a car fairs well in this study it does not necessarily mean that these cars are cheap to own and run, it just means that they are cheaper under the new rules than they were under the old.

It does suggest that if you have these cars within your car policy, then there could be less to worry about come the tax changes in April 2009.

Are there some general rules of thumb?

It is a complex situation however there are some general indicators: -

- ❖ Headline costs will always be higher and Net costs are likely to be higher on cars emitting more than 160g/km CO₂
- ❖ Headline costs will be marginally higher on cars emitting between 111g/km CO₂ and 160g/km CO₂ but Net costs may be marginally lower than they are currently.
- ❖ 'Flatter' depreciation curves are favoured under the new tax rules; subsequently longer, low mileage contracts will incur lower increases than high mileage more rapidly cycled cars.
- ❖ Your net position 'after leasing allowances' will be significantly different between cars emitting under and over the 160g/km threshold.

Application of these facts will help focus, but there are such large variances within the bands that it could prove costly to take a simplistic approach.

So what should we do?

What must be borne in mind is that for most cars, headline rentals will be increasing and unless you have a mechanism to incorporate the tax allowances on vehicle rentals, you will see some major increases in cost, or experience many vehicles dropping off your policy lists because of price. Given the CO₂ based 'Leasing Disallowance', it would be foolish to 'uplift benchmarks' across the board to meet the higher rentals; this would allow in cars that are higher emitting and will cost the company more in reduced tax allowances. Quite simply, a policy built on today's terms will not fit the new tax rules. It will need re-crafting to allow for the tax breaks on lower emitting cars.

You should seek advice from an industry professional, who has the tools to calculate to what degree your policy will be impacted by the changes. They will be able to tell you what the necessary adjustments to policy will be, and those that are practically deliverable to your employees, in order to protect your position.