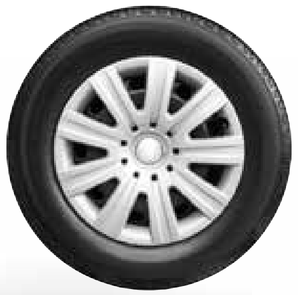
A PRIVATE PRACTICE

# Racing towards tax-efficient cars

**Ian Tongue** looks at the current position for those considering buying a car regarded as tax-efficient by the motor trade



## NHS FLEET SCHEME

**The NHS fleet scheme is available to most NHS employees and can appear attractive. The same 'benefit in kind' calculations apply, so low-emission cars keep the cost down.**

**But, in choosing an NHS fleet car, you have three main areas of cost to consider:**

- **The salary sacrificed and resulting loss of net pay;**
- **The benefit in kind;**
- **Potential loss of pension, particularly those in the 2015 pension scheme.**

**The key thing is to work out the total cost to see if this compares favourably to private ownership and that will depend on the car and your own circumstances.**

WITH THE Government recently announcing a ban on the sale of new petrol and diesel cars from 2040, it has naturally raised more interest in electric and ultra-low-emission vehicles.

A visit to the car dealer may leave you confused with the terminology and perhaps the seemingly too-good-to-be-true tax savings.

### What is tax-efficient?

There are different scales of tax efficiency, but, on the whole, people generally refer to tax-efficient cars as those attracting the 100% first year allowance – ultra-low-emissions or zero-emission cars.

For the tax year 2017-18, this is any vehicle with emissions with 75g/km or less, which usually means a fully electric or hybrid vehicle.

### The first year allowance

By some, this is seen as the holy grail of tax relief: you buy a car and are allowed to deduct this against your taxable profits in year one. Brilliant, but...

The first year allowance is an acceleration of tax relief rather than necessarily giving you something more than you may have had anyway. In particular, the mechanics of accounting for vehicles are different whether you are self-employed or trading as a limited company.

Additionally, leasing a car does not attract a first year allowance, as you are renting the car.

### Self-employed

If you are self-employed and using a private car for business, it can still qualify for the first year allowance if the vehicle has emissions of 75g/km or less.

However, the tax relief is restricted for business use only. Let's take an £80,000 electric sports car and compare the position to a gas-guzzler of the same cost with 50% business use.

For the electric car, this is an immediate deduction against your income tax liability in the year of acquisition. The car is purchased for £80,000 but you claim 50% of the cost at your marginal tax rate of, say, 45%. This is an £18,000 reduction to your income tax liability. Brilliant.

For the gas-guzzler car, the tax relief in the year of acquisition is only 8% and that is restricted for business use. This equates to only £2,880 tax saved. Not so good.

At this point, the salesmen of low-emission cars want you to feel like the taxman has gifted you a decent proportion of your vehicle and get you to sign on the dotted line. But what happens in subsequent years?

Let's roll things on to year four when the car is sold for £25,000.

The electric car has all of its tax relief in year one and so received no further allowances in years two or three. In year four, the car is disposed of and, because it is a privately-owned vehicle, a balancing charge arises on the £25,000 residual value.

In the year of disposal, you therefore pay additional income tax of £5,625 to dispose of the car, assuming tax rates remain stable. The overall tax saved is therefore £12,375 (£18,000 - £5,625).

For the gas-guzzler, it only received 8% allowances (restricted to 50% business use) in years one, two and three, and therefore has a 'tax value' of £62,295 in year four against a residual value of £25,000.

In year four, you can claim a balancing allowance of £8,391. Add this to the allowances given in years one, two and three, and you've guessed it, the tax relief is £12,375.

As you can see, you go from thinking the first year allowance is brilliant in year one to a position where you pay some of that tax relief back to dispose of your car!

For the self-employed, the first year allowance is merely a timing difference. If you want an electric car, buy one; if you want a gas guzzler car, buy one. Don't let the tax tail wag the dog!

### Company car

This is where it gets more complicated. If you were an employee negotiating with your employer and you were given a low-emission company car as part of your package, it would no doubt be beneficial.

However, what about those that own the company and therefore are restricting their disposal income – through lower dividends or salary – by buying a car through your company?

The same rules apply in terms of qualifying for the first year allowance as highlighted above, but as the vehicle is not privately owned, the rules are different in relation to the disposal charge or allowance.

In simple terms, the negative factor of paying back the tax relief on the disposal where you have claimed the first year allowance applies, but the big balancing allowance doesn't and the car continues to get drip-fed tax relief for a long time after disposal.

Eventually, you will end up in the same position as the sole trader scenario, but this will be less beneficial from a cash flow perspective.

Another fundamental difference with a company car is that you are also required to pay additional income tax personally on the 'benefit in kind' of being given a vehicle.

The benefit in kind is effectively like a notional salary and is calculated by reference to original list

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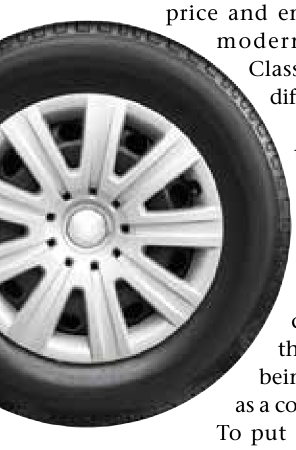

price and emissions for modern vehicles. Classic cars have different rules.

So, in this type of trading structure, the gas-guzzler becomes a huge tax charge for the privilege of being given this as a company car.

To put this in context, the electric car in the example above would attract an 8% benefit in kind rate for 2017-18, costing £2,880 a year in personal income tax for a 45% taxpayer, in contrast to the gas-guzzler, which would be a 37% charge against list price, amounting to £13,320 in income tax each year the car is provided.

Therefore, it usually makes little sense to have a medium- to high-emission car as a company car in your own business.

Additionally, you need to consider that the company pays National Insurance on the benefit in kind in a similar way to how it would if the benefit in kind was additional salary.

However, when you look at cars qualifying for the first year allowance, it can be tax-efficient, particularly as the 'benefit in kind' rate is set to fall to just 2% in 2020-21 – a cost of just £720 a year in the above example for an £80,000 car.

As with many decisions such as this, your own circumstances will determine whether you will save money overall when compared to extracting the money from your company and buying it personally.

If you are considering a company car, it is important that your accountant calculates the true cost for you in advance of your commitment to buy.

## The future

Clearly there is an irreversible drive to cut pollution and emissions that will lead to widespread electric vehicle ownership, particularly as these vehicles improve and range make them practical.

But what then?

The Institute of Fiscal Studies has predicted a huge slump in fuel excise duty and vehicle tax as we adopt electric vehicles, and that was before the announcement to stop the sales of new diesel and petrol vehicles in 2040.

The current benefit in kind for a fully electric vehicle is 8% and this is scheduled to rise every year until 2019-20 until it reaches 16% and then it drops all the way down to 2% for 2020-21. No information has been provided past that date.

Clearly, if there is a funding black hole, this rate will be reviewed. But who knows whether it will remain low to further encourage electric ownership, for a period of time at least.

Buying a car is a very personal thing and I always encourage clients to not chase the tax relief and buy the car that is most suitable for their needs, whether it be a people carrier, electric or a petrol/diesel sports car for all that hard work.

Whichever you choose, your trading structure will have a fundamental impact on whether it makes sense to have this as a company car. Involve your accountant in any vehicle considerations to ensure that, whatever you choose, you get the maximum tax relief available.

■ **Next month: Avoiding the long arm of the taxman**

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