Cars For Work

Use of a company car is a common part of a pay package. This article will look at the extra tax paid for the use of a company car, and the most tax-effective strategies for taking advantage of this benefit. All examples assume that the taxpayer is in the basic tax bracket of 20%, and that the additional benefit does not take them beyond it into higher rate tax.

Tax on a company car is calculated on the list price (nb – not the actual cost) of the car multiplied by a percentage based on its CO^2 emissions. For example, a car with CO^2 emissions of 140 g/km is taxed at 16% of its list price. (The percentage for diesel cars is 3% higher). If it has a list price of £12,000, the benefit is £1,920. This is the amount on which the employee is taxed. So if the employee is a basic rate taxpayer, the tax payable is £384. This is normally arranged by adjusting the tax code. There is no national insurance for the employee to pay on this benefit, although the employer does pay national insurance.

This means that for £384, the employee has the use of (usually) a new or newish car, with all insurance and maintenance paid by the employer, and no need to pay for a loan, or use savings. It is usually best for the employee to pay for their own fuel for private motoring, as there is a further tax if the employer pays.

The government is very keen for us to buy low CO^2 cars, and the rules have become quite favourable for employees who drive a low CO^2 vehicle. For cars with emissions of no more than 120 g/km, the percentage is only 10%, for both petrol cars and diesels.

Details of CO^2 emissions are available at
http://www.vcacarfueldata.org.uk/

An alternative for employees who need to drive in the course of their work is to use their own vehicle, and claim a mileage allowance from their employer. This can be paid (tax free) at 40p per mile for the first 10,000 business miles, and 25p per mile for further mileage. The employer may choose to pay less: if so, the employee can claim to deduct the balance on their tax return, or by using form P87, available from the HMRC website, www.hmrc.gov.uk

For example, Rufus drives 5,000 miles on business, and his employer pays him 25p per mile. Rufus can claim a deduction of £750 (5,000 x 15p) from his taxable earnings, and reduce his tax by £150 (£750 x 20%). Of course, it is better for Rufus if his employer pays the full 40p per mile.

That's a brief overview of the employee's point of view. What about the employer? There are several aspects to consider:

Corporation Tax
The running cost of providing cars for employees is a deductible expense, and Corporation Tax at 21% (for small companies) is saved.

Capital Allowances
The cost of purchasing the vehicles attracts capital allowances. Again, the level of CO^2 emissions is relevant. For cars of no more than 110 g/km, the allowance is 100%, so the full cost of the car can be deducted in the year of purchase.

Cars with higher CO^2 emissions are less favourably treated. From April 2009, cars with emissions of 160 g/km and above will receive an allowance of only 10% per year.

National Insurance
As mentioned above, employers pay NI at 12.8% on the benefit to employees. This of course is the same amount as they would pay on the equivalent salary.

Vat
Generally Vat cannot be reclaimed on cars. However, if the car is leased, 50% of the Vat payments can be reclaimed. In addition, Vat on maintenance costs can be reclaimed in full.

The above is a very brief overview. There are a number of variables which we have not considered above, such as employee contributions to either the capital cost or the running cost, the cost of accessories, older and classic cars, and the provision of fuel for private motoring. In addition, we have not looked at company vans, which can include many 4x4 vehicles, and which also have a relatively benign tax regime.

In summary, if a low CO^2 car is suitable, the combination of tax effects on employer and employee can be extremely beneficial from a tax point of view. In any case, the large number of variables involved means that it is well worth taking advice as to the best option for providing company cars. This is particularly the case for those who run their own companies.