

## Introduction

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Company cars remain a popular employment-related benefit despite the generally high income tax charges on them. The tax charge on company cars – cars provided to employees by their employers and available for private use – is based primarily on the cost of the car and its carbon dioxide (CO<sub>2</sub>) emissions. The rules are designed to favour cars with lower CO<sub>2</sub> emissions.

Many directors and employees do not have company cars, but use their own vehicles for business purposes. There are set rates, regardless of engine size, at which an employer can reimburse such employees without triggering a tax liability.

Where an employee is provided with a company car but is responsible for providing the fuel, HM Revenue & Customs (HMRC) publishes mileage rates that can be used for agreeing dispensations in respect of reimbursed business mileage for company car drivers.

This section explains the main rules and the factors to be considered in deciding between a company car and a car owned by the employee personally. All references to employees can be taken to include directors.

## How company cars are taxed

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The benefit of having a company car available for private use is taxed by reference to a notional amount of taxable extra income, known as its cash equivalent value. The employee pays tax on the cash equivalent at his or her marginal rate. The employer is liable to Class 1A national insurance contributions (NICs), but there is no liability to employee NICs.

The benefit of a company car is only taxable where a car is provided to a P11D employee or a director. However, the cash equivalent value of the car (and any other benefits provided to the employee) is taken into account in determining whether the employee earns at a rate of at least £8,500 a year.

For example, if the cash equivalent of a car is calculated as £5,000, then an employee who pays income tax at the higher rate of 40% will have a tax liability of £2,000. The employer will have a NIC liability of £690 (£5,000 × 13.8%) (2011/12 rate).

### Calculating the cash equivalent

There are four steps to calculating the cash equivalent of a company car.

1. Establish the price of the car for tax purposes. This is essentially the list price of the car plus the price of any optional accessories. For 2010/11 and earlier years, the list price is subject to a cap of £80,000 (such that cars with a list price of more than £80,000 are treated as having a list price of £80,000 for the purposes of the calculation). This cap is removed from 2011/12. Any capital contributions made by the employee (up to a maximum of £5,000) are deducted from the list price.
2. Multiply the list price (as adjusted for capital contributions and accessories) by the 'appropriate percentage' to produce the car's cash equivalent. This percentage is determined by the car's CO<sub>2</sub> emissions.
3. If necessary, reduce the cash equivalent for periods when the car was not available to the employee for part of the tax year.
4. Make an adjustment for any contribution made by the employee for the private use of the car.

## List price

The starting point of the calculation is the price of the car. This is the car's list price, including delivery charges, rather than the actual amount the employer paid for it.

- Where an employer has bought a car at a discount from the list price, it is important to keep records of both the actual price paid and the list price.
  - The list price is used in calculating the taxable cash equivalent of the benefit in kind.
  - The actual price is relevant for capital allowances purposes.
- The list price of a car is the one published by the manufacturer (or sometimes the importer or distributor) for a retail sale of the car in the UK. The relevant list price is the one published for the vehicle on the day before its first registration, regardless of the age of the car, or whether it was bought new or second-hand. It includes value added tax (VAT) as well as any customs or excise duty, whatever the VAT status of the employer.
- Accessories, such as air conditioning or special wheels, are not included in the basic list price. The tax rules regarding their treatment are complex, but in most cases the costs of any optional accessories attached to the car must be added to the list price of the car. Accessories that come as standard can be ignored. The cost of mobile telephones is not included.
- If the employee has made a capital contribution towards the cost of the car, the amount, up to a maximum of £5,000, is deducted from the list price.
- For 2010/11 and earlier years, there is an upper limit of £80,000 on the list price of company cars for calculating the benefit. The limit is imposed after deducting any capital contribution. This upper limit is removed from 2011/12, from which date the actual list price is to be used in the cash equivalent calculation where this exceeds £80,000.
- Where a car is at least 15 years old, its open market value (less any capital contribution) is substituted for the list price if the car is valued at £15,000 or more, as long as this value is higher than the list price.

## CO<sub>2</sub> emissions

The next stage in calculating the taxable cash equivalent of a company car is to apply the appropriate percentage to the list price. For cars first registered after 31 December 1997, the appropriate percentage is normally determined by the level of the car's CO<sub>2</sub> emissions. A higher level of emissions leads to a higher taxable cash equivalent.

CO<sub>2</sub> figures are available at the Society of Motor Manufacturers and Traders Ltd website (<https://www.smmmt.co.uk/members-lounge/member-services/market-intelligence/vehicle-data/co2-emissions-data/>) and are shown on vehicle registration documents for cars registered from 1 March 2001.

### The lower threshold

A lower threshold of grams of CO<sub>2</sub> emissions per kilometre is set for each tax year.

For 2011/12 and earlier years, the lower threshold corresponds to an appropriate percentage of 15%.

For the tax year beginning on 6 April 2011 (2011/12 tax year), this lower threshold figure is set at 125g/km. A petrol car with emissions up to this figure but above 120g/km will be taxed on 15% of its list price.

**Example 18.1 – Below the lower threshold but over 120g/km**

An employee drives a petrol car with a list price of £10,000 for the whole of the tax year 2011/12.

The CO<sub>2</sub> emissions figure for the car is 122g/km.

As this is below the lower threshold of 125g/km, but more than 120g/km, the appropriate percentage is 15% and the cash equivalent of the benefit is £1,500 (£10,000 × 15%).

The employee will pay income tax on the cash equivalent value of £1,500.

The employer will pay Class 1A NICs (at 13.8%) on the same figure of £1,500.

For 2011/12 and earlier tax years, where the CO<sub>2</sub> figure exceeds the lower threshold, the basic percentage of 15% rises by 1% for each additional 5g/km of CO<sub>2</sub> emissions to a maximum charge of 35%.

Any emissions figure above the lower threshold that is not divisible by five is rounded down to the nearest multiple of five. From 6 April 2012 (2012/13 tax year), the bands are extended so as to start at 10%. The 10% rate will apply to cars with CO<sub>2</sub> emissions of 99g/km or less. Cars with CO<sub>2</sub> emissions of 100g/km will attract a tax charge of 11%. Thereafter the charge will increase by 1% for each 5g/km increase in CO<sub>2</sub> emission to a maximum charge of 35%. The appropriate percentage is to be increased by 1% for cars with CO<sub>2</sub> emissions between 95g/km and 220g/km from 2013/14.

**Low emission rate (QUALECs)**

Petrol cars with actual (unrounded) CO<sub>2</sub> emissions of 120g/km or less are taxed on 10% of their list price. Such cars are known as qualifying low emissions cars (QUALECs). As a result of the changes in the bands to be introduced from 6 April 2012, the rules for QUALECs are abolished from that date.

**Ultra low emission cars**

From 6 April 2010, a lower rate of 5% applies to cars with actual (unrounded) CO<sub>2</sub> emissions of 75g/km or less.

**Zero-emission cars**

From 6 April 2010, for five years no charge (an appropriate percentage of 0%) applies in relation to cars, including electric-only cars, which are not capable of producing CO<sub>2</sub> engine emissions in any circumstances.

**Upper limit**

Whatever the level of the car's CO<sub>2</sub> emissions, the maximum cash equivalent of the benefit in kind is 35% of the list price. In 2011/12, the 35% charge applies to any petrol car with CO<sub>2</sub> emissions of 225g/km or above.

**Diesel cars**

Most diesel cars are subject to a supplement of 3%, and so the taxable benefit of a diesel will not usually be less than 13%. However, the 3% supplement is capped so that the maximum percentage charged is 35%. For 2010/11 and earlier tax years, the 3% supplement is not imposed on diesel cars registered before 1 January 2006 that meet the 'Euro IV standard'.

## Emissions table

The following table gives the taxable percentage of list price by emissions level:

### Car benefit charges for cars with an approved CO<sub>2</sub> emissions figure

CO <sub>2</sub> emissions in grams per km	Percentage of car's price to be taxed 2011/12	
	Petrol (%)	Diesel (%)
75g/km or less	5	8
120 or less but more than 75g/km	10	13
121 to 125	15	18
130	16	19
135	17	20
140	18	21
145	19	22
150	20	23
155	21	24
160	22	25
165	23	26
170	24	27
175	25	28
180	26	29
185	27	30
190	28	31
195	29	32
200	30	33
205	31	34
210	32	35
215	33	35
220	34	35
225 or more	35	35

- Cars at least 15 years old by the end of a tax year and valued at £15,000 or more are taxed at the appropriate percentage of market value.

## Alternative fuels

For years before 2011/12 discounts were given for cars that are capable of running on alternative fuels. These discounts were abolished from 6 April 2011.

However, from 6 April 2010 for five years no charge applies in relation to zero-emission cars. These are cars (including electric-only cars) that are not capable of producing CO<sub>2</sub> engine emissions in any circumstance. The charge is due to revert to 9% (6% discount) from 2015/16.

## Future years

From 6 April 2012 (2012/13 tax year), the bands are extended so as to start at 10%. The 10% rate will apply to cars with CO<sub>2</sub> emissions of 99g/km or less. Cars with CO<sub>2</sub> emissions of 100g/km will attract a tax charge of 11%. Thereafter the charge will increase by 1% for each 5g/km increase in CO<sub>2</sub> emission to a maximum charge of 35%. As a result, the rules on QUALECs are no longer required.

From 6 April 2013 (2013/14 tax year) the appropriate percentages will be increased by one per cent for cars with CO<sub>2</sub> emissions of 95g/km to 220g/km. The appropriate percentage for zero emission cars will remain at 0% and that for cars with CO<sub>2</sub> emissions of 75g/km or less will remain at 5%.

## Older cars

The percentage is determined in a different way for cars first registered before 1 January 1998. For these older vehicles, the taxable benefit is based on engine size (with no differential between petrol and diesel cars). The appropriate percentages are:

Up to 1,400cc	15%
1,401cc to 2,000cc	22%
Over 2,000cc	32%

## Cars with no CO<sub>2</sub> figures

A few cars registered since the start of 1998 do not have an official CO<sub>2</sub> emissions figure. In these cases, too, it is necessary to look at engine size, but this time with a differential for many diesel cars. The taxable percentages are:

	Petrol	Diesel
Up to 1,400cc	15%	18%
1,401cc to 2,000cc	25%	28%
Over 2,000cc	35%	35%

## Other adjustments

After calculating the taxable percentage of the list price, adjustments must be made if the car is unavailable for any period or if the employee contributes towards the costs of running the car.

### Cars unavailable for use

The taxable cash equivalent is reduced for periods where the car is not available for the employee's use. It is important to take care about this, because HM Revenue & Customs (HMRC) applies the rules strictly.

- If the car is available to the employee for part of the year only, the car benefit charge is reduced pro rata.
- Once a car has been made available to the employee for any period at all, a reduction is only given if the car is unavailable for a continuous period of at least 30 days. The 30-day period can span two tax years.

- Simply not using the car is not enough. If the car is available to the employee's family or household for their use, then there is no reduction.
- Similarly, no reduction is given if the car is technically available to the individual, even though they are unable to drive it. If, for example, the employee has broken a leg or been banned from driving, HMRC will not accept that the car was unavailable for the employee's private use.

To clearly establish that the car is not available for the employee's use, it is important that the employee hand the keys back to the employer.

This should be documented with a written note on file saying that the employee is not entitled to use the car until further notice.

### **Employee contributions**

Contributions that employees make for the private use of their vehicles are deducted from the taxable cash equivalent after all other reductions. HMRC interprets the rules in this area very tightly.

- There must be a requirement for the employee to make a payment and that payment must be made as a condition of the car being available for private use.
- The payment must be specifically stated to be for the employee's private use of the car. Payments for supplies or services, such as petrol or insurance, do not count.

It is important that any agreement between employer and employee be tightly worded, and, in cases of doubt, it would be worth clearing the wording in advance with the local PAYE office.

### **Other costs**

The cash equivalent of the car covers all costs incurred by the employer in connection with the provision of the car except for the cost of a chauffeur and fuel for private travel (see the separate topic 'The taxation of company cars').

- If a chauffeur is provided, the employee is charged tax on the cost to the employer.
- The employee is not taxed on congestion charges incurred while travelling in a company car and paid by the employer, irrespective of whether the journey that gave rise to the charge was business or private.

## **Tax planning**

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The car benefit rules do not take into account the extent of business use of a company car. The sales person who drives long distances on business every day is taxed in exactly the same way as the employee who goes to work by train and is given a car as a perk. This is because the benefit is derived from the fact that it is available for private use. Consequently, whether the tax cost to the employee of a company car is worth the benefit depends mainly on the amount of private use. The introduction of lower charges for low and very low emission vehicles has made it possible to provide company cars at a lower tax cost. From 6 April 2010 it is even possible to provide a company car tax free provided that the car in question meets the definition of a zero-emission car (essentially an electric-only car).

### **Private mileage**

The following examples show how the tax cost is related to private mileage. For others a company car can indeed be a valuable benefit. Providing modest cars to staff with high private mileage can be very attractive.

### **Example 18.2 – The high business/low private mileage driver**

Sarah covers 25,000 business miles a year as a sales rep. Because she drives so much in her work, she prefers to avoid long car journeys away from work, so she only covers 2,000 private miles a year. She drives a two-year-old car with a list price of £20,000. It is a petrol-driven car with an emissions figure of 242g/km.

The fuel emissions from her car exceed the maximum figure of 225g/km on the scale, and she will therefore pay tax on a cash equivalent value for the car of £7,000 (£20,000 x 35%).

If she is a 40% taxpayer, this is a cost to her of £2,800 for which she gets the benefit of 2,000 miles of private motoring, although she still has to pay for her petrol, which the cash equivalent does not cover. At £1.40 a mile for the car alone, this may seem a somewhat expensive 'benefit', especially as it does not even take into account the costs to the employer of providing the car and the employer's NICs of £966 (£7,000 × 13.8%). However, according to the AA, someone owning a £20,000 car and driving 5,000 miles a year would face total standing charges and running costs of over £1.30 a mile.

### **Example 18.3 – The high private mileage driver**

David has an office-based job 60 miles away from his home.

His main use of his vehicle is to get to and from work each day (such journeys do not count as business mileage for tax purposes). He chooses a diesel car with a list price of £10,000 and CO<sub>2</sub> emissions of 130g/km. His annual business journeys amount to only about 1,000 miles.

David is rewarded for driving a fuel-efficient car and the taxable cash equivalent is £1,800 (18% minimum percentage for a diesel vehicle). The cost to him, if he is a 40% taxpayer, is therefore £720, which covers all the costs except fuel for the 27,000 or so miles he travels to and from work in a year.

## **Reducing the tax charge**

There are several options for employees faced with a high tax liability, although most are not particularly attractive. The following could be considered:

- A lower emission car and/or a cheaper model will reduce the cash equivalent.
- A switch from the petrol to the diesel model of the same vehicle will often result in a substantially reduced tax charge. This is particularly so for executive cars, which in petrol form often attract the full 35% tax charge.
- The employee could simply accept that this is the position, as with any tax charge.
- The employer might recognise that the car is an essential tool for the employee's work and that the tax liability is excessive. The employer could therefore agree to pay the employee enough extra salary to compensate for the high tax on the car.
- The employer could establish a clear rule that the car is only available for the employee's business use. No taxable benefit arises if a car is not available for the private use of the employee or their family or household.
  - Where a car is made available to an employee, it is automatically taxed as if it were available for the employee's private use, unless there is a specific prohibition on such use and no such private use is actually made of the car during the tax year.
  - The car could not be used for home to work travel because this is automatically classed as private mileage.

- HMRC can be expected to scrutinise such a claim closely.
- Using a pool car would achieve the same result. A pool car is one that is used by more than one employee and is not used for private travel, except where such journeys arise incidentally.
- The employer could stop providing a company car and pay additional salary instead.
- The employer could offer the employee a choice of a company car or a cash alternative.

## Capital allowances

Capital allowances (the tax equivalent to depreciation) allow businesses to write off the cost of capital assets against their taxable profits.

The rate of capital allowances given depends on the level of the car's CO<sub>2</sub> emissions. Expenditure on cars is allocated to one of two pools. Those cars with CO<sub>2</sub> emissions of 160g/km or less are allocated to the main pool and attract a writing down allowance of 20% a year. Cars with CO<sub>2</sub> emissions of more than 160g/km are allocated to a special rate pool and attract a writing down allowance of 10% a year.

Cars with very low CO<sub>2</sub> emissions (110g/km or less) enjoy 100% first year allowances.

The annual investment allowance is not available in respect of cars.

Special rules apply to lease cars.

## Employee-owned cars

For many employees it is more attractive to own their car privately and charge their employer for any business mileage they drive. Further, drivers of smaller cars end up better off.

The only way an employer can reimburse an employee tax-free for business mileage is at a fixed rate of up to 45p per mile (rate for 2011/12 onwards) for the first 10,000 business miles in the tax year and 25p per mile thereafter, irrespective of the size of the car. If the employee is reimbursed at a higher rate, the excess is taxable. Reimbursement based on the actual costs of motoring is no longer tax-free.

### Example 18.4 – Employee's own car used for business

Sarah (from the example above) switches from using a company car to driving her own car, which is an identical model.

Her business mileage is still 25,000 miles.

She can claim tax-free reimbursement from her employer for 2011/12 as follows:

	£
10,000 miles @ 45p per mile	4,500
15,000 miles @ 25p per mile	3,750
Total reimbursement	£8,250

- If the employer does not pay the full mileage rates or does not make mileage payments, the employee can claim a tax deduction for the difference between the permitted mileage rates and the amount they are actually reimbursed.
- Any amount paid in excess of the approved amount for the tax year is taxable and must be returned on the employee's P11D or P9D, as appropriate. The approved amount for the year is the business mileage for the year multiplied by the approved mileage rate.

- Employees cannot claim tax relief for the actual costs of buying or running their own car, although they can claim capital allowances to the extent the car is used for business travel.
- In addition to the mileage payment, employers can pay employees up to 5p a mile tax-free if the employee takes a passenger on the journey who is also an employee on business. The rate is per passenger mile with no upper limit, so if two passengers are taken at the same time, the employer can pay 5p a mile for each. However, the employee cannot claim any tax relief for carrying a passenger where the employer does not make a payment.
- Before claiming the passenger mileage payment, employees should check whether their insurance company is satisfied that no profit or reward is involved and that their policy remains valid.
- The mileage rate is intended to reimburse the employee for all costs of business travel apart from parking, congestion charges, tolls and any other expenses that are incurred on a particular journey but are not related to the mileage itself. The employee can claim a tax deduction for these additional costs if they occur on a business trip, and is taxed on any amount reimbursed by the employer. Alternatively, these costs can be included in an HMRC dispensation, in which case the employer pays them free of tax and the employee does not claim a tax deduction.

## **Cash or car?**

It is often difficult to decide whether employees and directors are better off owning their cars or having a company car.

### **The employee's perspective**

In pure cash terms, and assuming that she is a 40% taxpayer, Sarah, in the examples above, would save tax of £2,800 (£7,000 at 40%) by owning the car personally, and her employer could pay her £8,250 tax-free in mileage allowances, which would defray the costs of running her vehicle. The starting point is therefore that she is better off by £11,050. Out of this, Sarah would have to pay for the petrol and general running costs of her car, including depreciation, and also interest if she needs a loan to buy the car.

### **The employer's perspective**

Sarah's employer would have to pay her £8,250 for business mileage, but would save all the running costs of the vehicle and the Class 1A NIC charge on the benefit of the car (£966 for 2011/12). Sarah would no longer have the benefit of an employer-funded car for her private use and her employer would probably pay her additional salary as compensation for this loss. Once this figure is agreed, it is possible to consider the income tax, corporation tax, NIC and VAT issues, and to reach a decision over whether the car is better provided by the employer or not.

In practice, many employers choose to compare the cost to the company of providing a car or paying salary instead. If a consistent cost to the employer can be maintained in both calculations, then it is possible to look at the employee position to determine the best approach overall.

Choosing between a company car and a privately owned car involves many subjective as well as financial issues, including:

- Cash flow for both employer and employee.
- Corporation tax, income tax, VAT and national insurance considerations.
- Administration costs of running a car fleet.
- Buying power, discounts, group insurance policies, etc.
- Employer control over the types of cars driven by employees.

- The fact that an employee who has been covered by an employer's car insurance might not qualify for any no claims bonus on a new private policy, although many insurance companies do make concessions for ex-company car drivers.
- The need for accurate records of business mileage driven in private cars but not in company cars (unless business fuel, but not private fuel, is reimbursed).

## Making the transition

Making the switch from company car to personal ownership can cause difficulties. One approach is simply to transfer the car from the employer into the personal ownership of the director or employee. The employee will then be taxed on the market value of the vehicle at the time of transfer, unless the employee pays for the car.

- For example, an employee might be driving a company car with a list price of £20,000 that actually cost the employer £18,000 and is now worth only £10,000. If the employer transfers it to the employee without charge, the employee will be taxed on £10,000, the market value at the time of transfer.
- Alternatively, the employee could pay all or part of the full market value for the car. The payment will reduce the amount on which the employee is taxed (although the total cost to the employer will be higher).
  - The employer could make a loan to the employee to help finance the purchase. There will be no tax charge as long as the total of all loans from the employer to the employee does not exceed £5,000 at any time in the tax year.
  - Larger loans would mean that the employee would face a tax liability if the loan were interest-free or at a very low rate (less than 4% in 2011/12).
  - If the employee is a shareholder, a loan might also give rise to a tax charge on the employer, and where a company makes a loan to a director, there could be company law issues to consider.

## Fuel for company cars

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### Private fuel for company cars

The tax charge on a company car does not cover fuel for private motoring provided or reimbursed by the employer. There is an additional tax charge on car fuel, which, like the tax charge on the car itself, is based on CO<sub>2</sub> emissions.

- The starting point is the same 'appropriate percentage' figure based on emissions (or engine size for certain cars) that is used to calculate the cash equivalent of the car itself. The cash equivalent of the car fuel is then that percentage of £18,800 (2011/12).
- The maximum cash equivalent, corresponding to the 35% ceiling, is therefore £6,580 (35% of £18,800) and the minimum, corresponding to 5% is £940.
- The car fuel charge is reduced proportionately if the employer does not provide fuel for private use throughout the whole tax year or the car itself is unavailable for part of the year. However, the full amount is charged if provision of fuel is withdrawn and then reinstated before the end of the tax year.
- There is no reduction if the employer only pays for some, but not all, fuel for private use in a period.

## Reimbursing business fuel

Where a company car is used for business mileage and fuel is not provided, the employer may pay mileage rates for business travel instead. The approved mileage scheme only applies to mileage payments made to an employee using his or her own car for business mileage, not to those using a company car.

However, HMRC publishes advisory fuel rates for company car drivers. The rates can be used in negotiating dispensations, which effectively enable the payments to be made tax free without any associated reporting requirements.

The rates, which apply from 1 March 2011, are as follows:

	<b>Petrol</b>	<b>Diesel</b>	<b>LPG</b>
Up to 1,400cc	14p	13p	10p
1,401 to 2,000cc	16p	13p	12p
Over 2,000cc	23p	16p	17p

Of course, in order to claim reimbursement for business fuel, the employee must keep records of business mileage.

## Tax planning key points

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- 'Executive' company cars have generally not been a tax-efficient perk for many years. However, very low or zero emission cars can be tax efficient.
- If an employee needs a car for business travel, the question of whether a company car should be provided will depend on the individual facts in each case.
- Some employees will prefer to suffer the tax charge in order to benefit from the convenience provided by a company car.
- Regardless of whether a car is owned by the employee or provided by the employer, the income tax rules now patently favour smaller fuel-efficient cars.
- In many cases the provision of fuel for private motoring in a company car will not be tax efficient unless the employee does high levels of private mileage.

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at September 2011, which are subject to change.*