Summary: Intervention & Options

Department /Agency: HM Treasury	**Title:** Modernising tax relief for business expenditure on cars	
Stage: Implementation	**Version:** 2.0	**Date:** March 2009

Related Publications: Modernising tax relief for business expenditure on cars: a technical note
http://www.hm-treasury.gov.uk/taxrelief_cars_technote.htm

Available to view or download at:

http://www.hmrc.gov.uk/ria/index.htm

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What is the problem under consideration? Why is government intervention necessary?

Businesses currently face restrictions on the extent to which they are allowed to claim capital allowances for expenditure on buying cars costing more than £12,000. There is an associated disallowance on the cost of leasing cars costing more than £12,000 that can be off set against profits when calculating tax liability. These rules have been identified by business as an area that would benefit from reform. Following a consultation in 2006 and an update in 2007 the Government announced at Budget 2008 its intention to reform the exisiting rules by moving to a CO2 emissions based regime.

What are the policy objectives and the intended effects?

The aim of the reform is to modernise the existing rules that relate to tax relief for business expenditure on cars in a way that reduces compliance costs while ensuring consistency with the Government's wider objectives on the environment and public finances. This measure is one of a wider package of measures that have been introduced to provide a framework of tax incentives to promote the switch to cars with lower carbon dioxide emissions.

What policy options have been considered? Please justify any preferred option.

The following options have been considered and consulted on since 2006.

1. Do nothing. 2. Replace the existing rules with new legislation based on CO2 emissions.

3. Straight abolition.

4. Place expenditure on cars in a new capital allowance pool, with a lower writing-down allowance than that of the general plant and machinery pool.

Option 2 is being introduced because it is the only option that meets the objectives for reducing compliance costs in a way that is consistent with wider policy objectives.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The Government will review the compliance cost impact of the measure after the end of the transitional period 5 April 2014.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:

Angela Eagle.

Date: **15/03/09**

Summary: Analysis & Evidence

Policy Option: 2	Description: Replace existing rules with new legislation based on CO2 emissions

COSTS

ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
One-off (Transition)	Yrs	The cost to business of complying with the new arrangements will, generally, be minimal. However, daily hire businesses and certain taxi operators will become subject to the new capital allowance and lease rental restriction (LRR) regimes. The admin burden of this is estimated to be between £50k- £400K.
£ Negligible		
Average Annual Cost (excluding one-off)		
£ Max £400k		Total Cost (PV) £ 1.9m

Other key non-monetised costs by 'main affected groups' All businesses affected by the measure will experience decreased cash flow as a result of full balancing adjustments no longer being generated on outstanding depreciation at the time of disposal of the car. Instead these outstanding balances will be fully relieved over time at 10% or 20% on a reducing balance basis.

BENEFITS

ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
One-off	Yrs	Businesses operating cars (which are not subject to the private use adjustment) will benefit from no longer having to maintain single asset pools for cars costing over £12,000. Expenditure will be allocated to one of two general pools. Those businesses that lease / hire cars will benefit from a simplified flat rate LRR.
£		
Average Annual Benefit (excluding one-off)		
£ 8m		Total Benefit (PV) £ 37.4m

Other key non-monetised benefits by 'main affected groups' While it is difficult to measure, this option is designed to complement measures aimed at encouraging the purchasing of cars with lower CO2 emissions in order to benefit the environment.

Key Assumptions/Sensitivities/Risks This option assumes manufacturers will continue to make advances in technology to introduce fuel-efficient cars and businesses take a more positive attitude towards using low-emission cars. Estimated Exchequer yield of around £55m in 09/10 with a total impact of £485m over the next five years.

Price Base Year	Time Period Years 5	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ 35.5m

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			April 2009	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes/No	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ See Annex	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase - Decrease)
Increase of	£ 50-350k	Decrease of	£ 7.25m	Net Impact	£ 6.9 - £7.2m

Key: Annual costs and benefits: Constant Prices | (Net) Present Value

Evidence Base (for summary sheets)

THE CURRENT RULES FOR BUSINESS EXPENDITURE ON CARS

Capital allowances allow the cost of acquisition of capital assets to be written off against a business' taxable profits. As such, they take the place of depreciation in the commercial accounts, which is not allowed for tax. There are special rules for calculating the tax relief available for business expenditure on cars and also for determining the amount of expenditure incurred on leasing cars that can be charged against profits.

For capital allowances, the rules for cars that cost more than £12,000 are:

- the car is not included in the general plant and machinery pool but accounted for separately in a single asset pool
- writing down allowances are restricted to a maximum annual amount of £3,000.

When an asset that has been dealt with in a single asset pool is disposed of, the pool ceases and a balancing adjustment (charge or allowance) is made. This brings the total allowances given during the period of ownership of the asset into line with the actual depreciation suffered on the asset over that period.

The £12,000 threshold has not been changed since 1992 and therefore applies to a significant proportion of all business cars – currently estimated to be more than 50%. Qualifying hire cars[1] are exempt from the existing rules and are therefore accounted for in the general plant and machinery pool, regardless of cost. Cars with emissions of 110g/km or below qualify for 100 per cent first year allowance and are exempted from these rules regardless of their cost. The administrative burden for cars that are used partly for non-business purposes will not be affected by these reforms. This is assumed to be the case for cars owned by the majority of the smallest businesses.

An example of the tax calculations for a car costing £20,000 that is sold after four years for £9,000 is shown in the table below.

Illustrative example of capital allowance (CA) restrictions

	WDV[2] b/f	Purchases	Disposals	CA	WDV c/f	Tax implications[3]
Year 1	0	20,000	0	3,000	17,000	-840
Year 2	17,000	0	0	3,000	14,000	-840
Year 3	14,000	0	0	3,000	11,000	-840
Year 4	11,000	0	9,000	2,000[2]	0	-560

[1] These include certain taxis, Daily Hire cars, and Cars leased to the disabled.
[2] Written Down Value (WDV)
[3] based on a tax rate of 28%. For unincorporated businesses and companies not subject to the full CT rate, this will not apply.

For the lease rental restriction

Under the current rules for taxation of business expenditure on cars there is also a restriction on the amount of expenditure incurred on the hire of a car that is deductible in computing taxable profits (the lease rental restriction (LRR)). Ordinarily leasing costs can be deducted in full. However, in the case of cars costing more than £12,000, a formula restricts the amount that can be claimed. This restriction is a permanent disallowance and is currently applied to every lessee in a chain of leases. It was introduced to prevent businesses circumventing the restriction on the capital allowance rules by hiring rather than buying their motor vehicles.

BACKGROUND TO INTERVENTION

Over the years the Government has received representations from business that the present system is in need of reform. This has been mainly on the grounds that the current rules impose a compliance burden because of the need to maintain a single asset pool for each car costing over £12,000. For owners of large fleets this can result in a particular burden as cars tracked separately in this way can number hundreds.

Another reason put forward by business for the change is that the current regime is outdated because the cost threshold for the single asset pool treatment has not been updated for many years. Some businesses suggest that, at the very least, the threshold needs to be raised in order to bring the rules back into line with the policy intention when they were first introduced, which was to restrict allowances for luxury cars. This option was considered, but rejected because it was not in line with Government's wider objectives.

CONSULTATION AT BUDGET 2006

At Budget 2006 the Government launched a formal consultation on modernising tax relief for business expenditure on cars. In particular it set out a number of options, and specifically sought views on a preferred option.

The following options in bold were set out in "Modernising tax relief for business expenditure on cars"[4]:

1. Do nothing.

2. **Treatment of expenditure on cars in a new pool alongside a range of first-year allowances based on CO_2 emissions.**
   (Preferred option)

3. **Straight abolition. *It was considered, however, that this option would run counter to the Government's environmental objectives*.**

4. **Treatment of expenditure on cars in a new capital allowance pool for cars, with a lower writing-down allowance than that of the general plant and machinery pool. *It was pointed out, however, that this option would be inconsistent with the Government's environmental and fiscal objectives.***

Following the consultation the Government published an update in Budget 2007, which sought further comments on a refinement of its preferred option. A summary of responses to both the original consultation, and the update, was published in October 2007.

[4] http:www.hm-treasury.gov.uk.budget/budget06/other documents/bud bud06 cars.cfm

The refined option was to:

- place cars with CO_2 emissions not exceeding 165g/km in the general plant and machinery pool

- introduce a new pool, with a lower writing-down allowance than that of the general plant and machinery pool, for cars with CO_2 emissions above 165 g/km.

BUDGET 2008

Budget 2008 announced the Government's proposals following the consultation, and stated that with effect from 1 April 2009 for corporation tax purposes (6 April 2009 for income tax) the capital allowance treatment of all cars will be reformed. Expenditure on cars with CO_2 emissions above 160g/km will attract 10 per cent Writing Down Allowance (WDA) and expenditure on cars with CO_2 emissions of 160g/km or below (but above 110 g/km) will attract 20 per cent WDA.

The Government also announced its intention that, subject to State aid approval, cars leased to those in receipt of certain disability allowances will be placed in the 20 per cent main pool, regardless of their CO_2 performance.

The rules, which disallow a proportion of car lease rental payments, will be reformed in line with the new capital allowances rules. The new disallowance will be 15 per cent of the relevant payments, applied to cars with emissions above 160g/km. The Government also announced that it was considering the option of applying the disallowance only to the final business user in a chain of leases.

Having considered all the options for reforming the rules for business expenditure on cars in the light of its policy objectives, the Government believes that the "do nothing" option would not be appropriate. Option 2 is, in the Government's opinion, the best option. A Technical Note with draft legislation, explanatory notes and an Impact Assessment was published on 8 December 2009 to allow interested parties to make technical comments. The period for comment ended on 27 February 2009. A summary of responses can be found in Annex 2.

THE NEW RULES FOR TAX RELIEF FOR BUSINESS EXPENDITURE ON CARS

With effect from 1 or 6 April 2009 the current rules will be abolished and replaced with the following.

- Qualifying expenditure on all cars with CO_2 emissions above 110 g/km but not exceeding 160g/km will be placed in the main plant and machinery pool and attract 20 per cent WDA on a reducing balance basis.

- Qualifying expenditure on cars with CO_2 emissions greater than 160g/km will be placed in the special rate plant and machinery pool and attract 10 per cent WDA on a reducing balance basis.

- The lease rental restriction (LRR) will only apply to leases commencing after 1 April 2009 (6 April for Income Tax purposes) for cars with CO_2 emissions over 160g/km and will be applied at the flat rate of 15%. Further, it will only be applied to one lessee in a chain of leases.

The new rules represent a simplification.

- They replace the requirement for businesses to maintain single asset pools (except where there is non-business use of the car) for cars costing over £12,000 by utilising two existing plant and machinery pools, the main (20 per cent) pool and the special rate (10 per cent) pool.
- The LRR is simplified by replacing the formula with a flat rate 15 per cent disallowance. The disallowance will only be applied to one lessee in a chain of leases.

Transitional Arrangements

The current rules will continue to apply for expenditure incurred before 1 April 2009 (for Corporation Tax) or 6 April 2009 (for Income Tax) for a period of five years; any balance of unrelieved expenditure will then be transferred to the main (20 per cent) plant and machinery pool. However expenditure on cars that is dealt with in single asset pools due to the need to make "private use adjustments" will remain in single asset pools until the car is disposed of. The existing LRR rules will continue to apply to leases that commenced before 1 or 6 April 2009 until the expiry of the lease.

As the majority of business cars are owned by larger businesses and are disposed of within 36-48 months of acquisition, the number of cars that will still be held after five years by these businesses is expected to be small.

ASSESSMENT OF POTENTIAL IMPACTS OF OPTION 2- REPLACING EXISTING RULES WITH NEW LEGISLATION BASED ON CO2 EMISSIONS

Population of Vehicles

HMRC receive annual sales data for new cars which shows the number of car sales to businesses by the specification of the model, fuel type, engine size, transmission type, number of doors, body type, drive (4 or 2 wheel), list price, mpg, CO_2 emissions g/km, discount price and estimates of the residual values of the vehicles after years 2 to 5.

As at December 2008 it is estimated that there were approximately 3 million cars in business use – this includes hire cars, cars provided to employees as part of their remuneration package, and those registered to proprietors of unincorporated businesses. Approximately 1.4 million new cars are sold to businesses within the UK each year. The latest currently available data covers sales to 2007.

Economic Impact

The new policy will potentially impact on all business sectors that purchase or hire cars. The economic benefits come from reducing the administration burden of complying with the existing rules.

Small Business

In calculating the impact on businesses it is assumed that the majority of the smallest unincorporated businesses will have some private usage of their business vehicles. As such, these businesses will still be required to track expenditure on these vehicles in single asset pools, and it has been assumed they will not experience any reduction in admin burden as a result of the measure.

Qualifying Hire Cars

At present, expenditure on qualifying hire cars (covering daily hire cars, cars leased to the disabled and taxis other than black cabs) is accounted for in the general plant and machinery pool, regardless of their cost. However, under the new rules, these will be subject to the CO_2 emissions-based regime, and be accounted for in one of the two plant and machinery pools. Expenditure on these cars is already dealt with in the general pool so currently there are no balancing adjustments on disposal. It is expected that most of the businesses affected will be large, and many of them will already be operating 10 per cent capital allowance pools for assets other than cars. As such the administration cost of having to record some cars in the 10 per cent pool rather than the 20 per cent pool (the current state of play) is considered to be negligible. There is likely to be a marginal admin increase in costs for certain large businesses that will need to carry out some minor modifications to accounting systems in order to record their CO_2 emissions. The businesses most likely to be affected are those in the daily hire sector, and the incremental cost has been factored in to the admin burden calculations.

Cars costing less than £12,000

The new rules are based on CO_2 emissions, not cost, and it is estimated that some 280,000 cars that cost less than £12,000 have CO_2 emissions exceeding 160g/km. In future if a business incurs qualifying expenditure on such cars the expenditure will be allocated to the special rate pool because of their CO_2 emissions. For smaller businesses that may not, in the normal course of events, operate a special rate pool, this could result in their having to maintain two capital allowance pools for the first time.

Cars subject to LRR

The reform of the lease rental restriction will give an admin burden saving for businesses leasing cars that were previously subject to the old rules, as the restriction will only apply to one lessee in a chain of leases. The flat rate of 15 per cent will also mean that a lessee will no longer need to know the retail price when leasing a car but will now only need to identify a car's CO_2 emissions.

The restriction has been retained to prevent business circumventing the lower rate of WDAs for cars with higher CO_2 emissions by leasing from overseas lessors (who may enjoy more generous capital allowances (for these cars) than are available in the UK). A flat rate disallowance of 15 per cent will be more favourable to lessees of more expensive cars than the previous rules. It is estimated that the admin burden savings arising from the flat rate disallowance as compared to the previous formula will be considerable.

Qualifying hire cars: certain taxis, Daily Hire cars and Cars leased to the disabled

The cars leased or rented across these sectors were previously exempt from the expensive car rules. Expenditure on these cars was pooled in the main plant and machinery pool regardless of the cost. Under the new rules expenditure on cars emitting CO_2 over 160g/km will be dealt with in the special rate (10 per cent) pool and high-emission leased cars subject to the 15 per cent flat-rate disallowance.

At Budget 2008 the Government indicated its intention to provide special treatment for cars leased to the disabled (subject to State aid approval); this remains the Government's intention. However this has been deferred for the present time. The impact of this deferral is included as a small part of the Exchequer impact of the wider measures set out below.

Environmental Impact– carbon assessment

Although the CO_2 savings attributed to this policy are difficult to estimate separately, the Government expect some behavioural effects to result from linking the tax treatments to CO_2 emissions. As VED and Company Car Tax are also emissions-based tax regimes there should be a behavioral shift towards the purchase of cars with lower levels of emissions resulting from the combined incentive effect of all the measures.

In addition to direct Government intervention, reductions in CO_2 emissions by cars are believed to have been influenced by a variety of other factors including increased consumer awareness of environmental concerns, expectations of a more volatile fuel price and increased penetration of diesel powered cars as a share of the car stock brought about by new better performing engine technology.

It should be noted that analysis has indicated that for the majority of high emission (particularly petrol) engine cars, there are near equivalent lower emission models of a similar price and specification (most often available from the same manufacturer) e.g. a diesel equivalent model. It is expected that the new rules may act (in conjunction with other factors) to influence some businesses to switch to lower-emission equivalent diesel models.

Estimates of effects on administrative burdens

Overall, the annual admin burden savings including the simplification of the lease rental restriction (when the measure becomes fully effective) are estimated to be around £8 million. This has been calculated using the Standard Cost Model fixed at 2005 prices up rated to reflect 2008 prices (see Annex for analysis of the administrative burden). This estimate was derived by comparing the estimated admin burdens for businesses that will be subject to the new rules with the admin burdens of continuing with the existing arrangements. In total it is estimated that the overall admin burden should fall almost 30% of the baseline. As the car hire sector is dominated by large operators the overall cost to them of the new regime is estimated at between £50,000 and £400,000 p.a. with the cost likely to lie towards the lower end of this banding.

Estimates of effects on HMRC staff costs

There will be no increase in HMRC administrative costs in ensuring compliance with the new legislation, as compared to the old. HMRC will need to develop guidance for compliance staff and business to enable them to fully understand the new rules. However, these will be minor costs and hence are not monetised.

Exchequer Impact

The estimated Exchequer impact of this reform has been updated since PBR to reflect the legislative changes necessary to achieve the policy objective following the December 2008 consultation on the draft legislation. The costing assumes that the measure will be effective from April 2009. The cost to businesses in the table below includes the impact of qualifying hire cars, which will now be included in the rule changes (all figures are £'s million).

Year	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**5 yr total**
Exchequer Impact (£m)	**0**	**+55**	**+105**	**+115**	**+210**	**+485**

Although business will be able to receive tax relief for all their expenditure under the new arrangements, it will accrue more slowly than hitherto because balancing adjustments will no longer be made on disposal of cars where expenditure was allocated to single asset pools under the current rules.

Transitional Arrangements

The administrative costs of moving to the new arrangements are expected to be negligible. Where businesses maintain both main and special rate pools, the cost of changing systems to track expenditure on high emission cars in the special rate pool is expected to be negligible.

In the main, any transitional cost could fall on smaller businesses that do not operate a special rate pool and do not have any non-business use of their vehicles. It is difficult to estimate the transitional cost to these businesses accurately, but it is expected to be low.

IMPACT ON BUSINESS OF THE NEW RULES

BENEFIT	COST
Businesses purchasing cars (which are not subject to the private use adjustment) which are not qualifying hire cars will benefit from no longer having to maintain single asset pools for cars costing over £12,000. Expenditure will be allocated to one of two general plant and machinery pools. Businesses purchasing qualifying cars that cost over £12,000 will no longer be restricted to the maximum writing down allowances of £3,000 per annum. The Lease Rental Restriction will only apply to one lessee in a chain of leases. The current formula for calculating the amount of rentals that are restricted will be replaced by a flat rate disallowance applying to all leases with CO_2 emissions above 160 g/km. Lessees under new leases of qualifying cars worth more than (approximately) £17,000 with CO_2 emissions above 160g/km will no longer suffer from deducting higher LRR than 15 per cent flat rate.	Pooling expenditure in the plant and machinery pools will mean that businesses will no longer be able to make balancing adjustments on the disposal of cars. Instead full relief will be given through the 10 per cent or 20 per cent pools (as appropriate) over time. Businesses that currently purchase cars costing less than £12,000 but that have CO_2 emissions over 160 g/km will be subject to the lower WDA. Lessees under new leases of qualifying cars worth between (approximately) £12,000 and £17,000 and with CO_2 emissions above 160 g/km will suffer a higher rate of disallowance than under the previous LRR rules. Lessees under new leases of qualifying cars that emit over 160 g/km CO_2 and that cost less than £12,000 will now be subject to a 15 per cent flat-rate restriction. Manufacturers producing both petrol and diesel car models with emissions generally over the 160 g/km CO_2 limit may find businesses switch to similarly-priced lower-emission models which may potentially be produced by rival car producers.

SPECIFIC IMPACT TESTS

The various elements of this measure would apply to all UK businesses that own or hire business cars. They are not expected to have any legal aid impacts. The new rules are in accordance with the principles of sustainable development and are compatible with the Human Rights Act. They would not have a significantly different effect in rural areas.

Neither would they significantly impact on:

- Health and well being;
- Race equality
- Gender equality

Disability equality

At Budget 2008, the Government announced its intention that, subject to State aid approval, expenditure on cars leased to those in receipt of certain disability allowances would be placed in the 20 per cent pool, regardless of their CO_2 performance. This remains the Government's intention. However, the Government has agreed with the main UK supplier of leased cars to disabled people that it would be in the best interests of their customers to defer an application for State aid approval at the present time. Initiatives are being taken to increase the availability of cars with low emissions for lease by disabled people within a wide choice of affordable cars.

Environmental Tests

- Waste management.
- Air quality.
- The appearance of landscape and towns.
- Habitat and wildlife.
- Noise levels and climate change.

As mentioned earlier it is difficult to assess the extent of the environmental impact of this measure, but some positive behavioural effects are expected to result from linking the different tax treatment to CO_2 emissions.

Sustainable development and other environmental concerns

The five principles of sustainable development.

- Living within environmental limits.
- Ensuring a strong, healthy and just society.
- Achieving a sustainable economy.
- Promoting good governance.
- Using sound science responsibly.

This measure is intended to contribute to delivery of the above five principles as part of a package of measures aimed at incentivising businesses to purchase lower-emission cars.

Small Firms Impact Test

All business cars have been included in the reform as it aims to be consistent with the Government's wider environmental objectives to promote the switch to cars with lower CO_2 emissions. The 2006 Budget consultation specifically invited comments on the impact the proposals would have on self-employed individuals and other unincorporated businesses.

Small businesses with cars used for both business and non-business use will continue to allocate expenditure to single asset pools to enable an adjustment to be made to disallow the proportion of the allowances attributed to non-business use. As such, small business may be impacted less than large business. If a car has dual-purpose use then the qualifying expenditure will be allocated to a single asset pool. However, unlike the old rules the rate of WDA of the single asset pool will depend on the car's CO_2 emissions. There will be a balancing adjustment made when the pool ceases whether the rate of writing down allowances is 10 per cent or 20 per cent.

Small businesses have been specifically included in this measure to incentivise the purchasing of cars with lower CO_2 emissions. Also to the extent that self-employed individuals and other unincorporated businesses (e.g. partnerships) provide cars for their employees, or own cars they do not use for purposes other than business, those unincorporated businesses would enjoy the same compliance cost savings as companies would from the new measure.

There may be some very small businesses that incur expenditure on cars that are used wholly for business purposes. If the car's CO_2 emissions are more than 160g/km these businesses will need to maintain a special rate pool of expenditure for plant and machinery in addition to the main pool. This might potentially give rise to a slight increase in administrative burdens because it is unlikely they would own any other assets for which the expenditure is dealt with in the special rate pool. However these businesses are potentially able to benefit from the new rules introduced at Budget 2008 that enable businesses to claim a plant and machinery writing down allowance of up to £1,000 where the unrelieved expenditure of the main pool or the special rate pool is £1,000 or less.

Competition Assessment

Manufacturers are continuously innovating to produce lower carbon emitting cars such as hybrid, electric and bio-fuel cars. Some manufacturers may be affected because businesses may switch to lower-emission alternatives. However this measure in the long term is not expected to have any adverse impacts on competition, as it should not:

- directly limit the number or range of suppliers;
- indirectly limit the number or range of suppliers;
- limit the ability of suppliers to compete; or
- reduce suppliers' incentives to compete vigorously.

This measure does not affect cars subject to the private use adjustment, i.e. to the majority of the smallest businesses. The Government do not expect that the four dimensions of competition outlined above will be affected by the fact that this measure affects different sizes of business in different ways

RISKS

Many of the administrative burden and compliance cost estimates in this assessment are based on assumptions. These are informed by the most recent data available. However, they are believed to be broadly indicative of expected impacts.

IMPLEMENTATION TIMETABLE

The final legislation for the new policy is scheduled to apply to all qualifying expenditure incurred after 1 April 2009 (for Corporation Tax) and 6 April 2009 (for Income Tax).

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

Annex 1

Analysis of the administrative burden

HMRC is committed to reducing the administration burden placed on business in disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model'[5] (SCM), an activity-based costing model which identifies the activities a business has to do to in order to comply with HMRC's obligations, and then estimates the cost of these activities, including agent fees and software costs. The Impact Assessment template requires SCM figures to be presented in relation to a May 2005 baseline, that is, the prices and populations on which the original data was produced.

The present administration burden costing uses the same SCM approach, based on an estimation of how the baseline data has changed. As a matter of principle, the baseline is taken as a given and is not reviewed. The purpose of the present cost estimates is to assess how burdens might have changed in relative terms. Using this approach, the SCM model indicates that this measure will produce an overall reduction in the administration burden of just over £7m, based on the following assumptions:

The baseline burden relating to the existing "single asset pool" capital allowance arrangements for cars costing more than £12,000 is just over £10m. This burden should be removed for businesses which place all qualifying cars in one of the two general pools in future. Cars subject to the private use adjustment are excluded as they will continue to be accounted for in single asset pools. As a result, it is assumed that the global burden should be reduced by around three quarters. According to the database baseline this generates a total administration burden saving of just over £7.5m.

However, there is also an additional burden of moving to these new pools. It has been assumed that all the cars owned by businesses with no employees ('nano businesses') have an element of private use, and are therefore subject to the private use adjustment, i.e. that they will still be required to maintain single asset pools in respect of these cars. The database baseline assumes that around 550,000 nano businesses and around 200,000 other businesses are affected by the private use requirements. For all other businesses it is assumed that the burden of each of the new pools is half that of the current long life assets pool (in terms of the in-house business costs), and that where an agent is used, the agent's fee is around a third of that applying to the current long life assets pool. According to the database baseline these assumptions generate a total increase in admin burdens of around £3m.

Qualifying hire cars are presently exempt from the existing rules. Including these going forward is estimated to impact on just over 2,000 businesses. According to the database this generates a total increase in admin burdens of just over £100,000. The £400,000 upper limit mentioned in the summary page was based on more cautious assumptions covering how the new administrative costs might impact on the daily car hire sector. As such it can be regarded as a theoretical upper limit of the increased administration burden that could impact the sector.

The burden of the Lease Rental Restriction (LRR) is identified separately in the administration burden baseline. The baseline data assumes that the LRR will not generally apply to nano businesses, but does apply to all other sizes of business, of which the baseline assumes there are around 650,000. The existing baseline burden of the LRR is just under £15.5m. It has been

[5] Figures in annex are rounded, unlike those in the summary sheet. This explains why the sum of the figures from the annex does not appear to equal the figure in the summary sheet.

assumed that the existing in-house business costs of the current obligation will fall by one sixth in the future, and that where an agent is used, the agent's fee will also fall by one sixth. This results in a total reduction in administration burdens of around £2.5m. These savings assume that there will be limited change to information retrieval costs, but there will be savings associated with the assessment of information which has been retrieved, performing the necessary calculations, presenting figures, and then with checking the calculations and presentation.

In total these assumptions generate an administration burden reduction of between £6.9-7.2m (based on 2005 prices and data) relative to an initial total administration burden baseline of £25.5m. This constitutes a reduction in the baseline of almost 30%. Up-rating the 2005 data to 2008 prices gives the £8m per year savings shown on the summary page of this impact assessment (N.B. figures have been rounded).

Annex 2

December 2008 Technical note on modernising tax relief for business expenditure on cars
Summary of responses

Introduction

Following two rounds of consultation, the Government announced at Budget 2008 its intention to reform the tax relief available for business expenditure on cars and to introduce new rules that would reduce compliance burdens and have an environmental focus. A Technical Note with draft legislation, explanatory notes and an impact assessment was published on 8 December 2008 to allow interested parties to make technical comments. This Summary sets out the main views received on the points for consideration both in general terms and, where possible, against specific questions raised in the consultation document.

History of the consultation

During the first phase of the Budget 2006 consultation there were 23 responses from a wide range of stakeholders. Building on these responses, the Government published an update in Budget 2007, which sought further comments on a refinement of its preferred option. Overall, most respondents who commented on the merits of the refined proposal felt that it offered an improvement on the option aired in the previous consultation document and that it was simpler. A summary of the responses received to both the 2006 consultation and the 2007 consultation update was prepared and published in October 2007.

Policy background

In light of the responses received, the Government announced that the existing capital allowances rules for cars costing over £12,000 would be replaced by an emissions-based regime. The related restrictions on lease rental payments would also be replaced by a flat rate disallowance, but only for cars with CO_2 emissions above 160g/km. The further details announced were as follows:

- The existing 100 per cent first-year allowances for cars with very low CO_2 emissions would be extended for a further 5 years (from 1 April 2008 until 31 March 2013) with a lowered CO_2 emissions threshold of 110 grams per kilometre (g/km). This extension was enacted in Finance Act 2008.
- From April 2009, capital expenditure on other cars will be allocated to one of the two main plant and machinery pools –
    - expenditure on cars with CO_2 emissions of 160g/km or below will be allocated to the main pool, attracting writing-down allowances of 20 per cent a year, and
    - expenditure on cars with CO_2 emissions above 160g/km will be allocated to the 'special rate' pool attracting writing-down allowances of 10 per cent a year.

Responses to the 8 December 2008 Technical note

There were 15 responses to the Technical note from a range of stakeholders (Five professional representatives, nine business representatives and one corporate entity). The responses were largely a mixture of general comments on the Government's reform alongside responses to individual questions posed within the technical note.

Comments to specific questions

1. Do the draft clauses deliver the Government's stated policy aims, and, if not, what changes are required to do so?

Overall there was agreement that the proposed legislation delivered the policy objectives and a shared view that the legislation offered simplification, in particular the removal of the Lease Rental Restriction from every link in a chain of leases. One respondent noted disappointment that no alternative option was put forward to deal with cars with a private use element. Only two respondents argued that the new rules did not achieve simplification and will not reduce compliance costs, one of the respondents suggested that the existing £12,000 expensive car limit should be raised to £25,000.

2. Would it be a desirable simplification to exclude motorcycles from the capital allowances definition of a "car"?

Five respondents commented on the treatment of motorcycles and the majority agreed that this was a reasonable simplification.

3. Is the proposed 5-year transitional period reasonable?

Noting that the consultation indicated that the Government is proposing a five-year transitional period eight respondents provided comments. Most of the respondents commented that this was appropriate given that most cars are likely to be replaced three or four years after acquisition. One respondent added that the extent to which the transitional period becomes a burden, in particular to small businesses, is very dependent on the availability and clarity of HMRC guidance. Another respondent suggested that the transitional period could actually be shortened to enable businesses to reduce their record-keeping requirement sooner.

4. Would it be reasonable to allocate all expenditure incurred after commencement on cars registered before 1 March 2001 to the main (20 per cent) capital allowances pool?

Eight respondents commented that allocating all expenditure on cars registered before 1st March 2001 to the main pool is a reasonable simplification.

5. Would it be reasonable to allocate expenditure on all cars, registered on or after 1 March 2001, without an approved CO2 emissions figure, to the special rate (10 per cent) pool?

From the eight respondents that provided comments on whether it was reasonable to allocate expenditure on all cars that do not have approved figures for CO_2 emission to the special rate pool, seven were in favour. One respondent pointed out that there is likely to only be a very small number of cars registered after 1 March 2001 without an approved CO_2 figure and thought that it would be more reasonable to allocate these to the general pool.

General comments

Definition of a car

Although industry welcomed the simplification of the definition of a “car”, one respondent noted that more explicit exclusions should be made for businesses that operate certain vehicles necessary for specific tasks and are consequently restricted in their choice of vehicles.

Emissions certificate

One respondent also pointed out that under the proposed rules businesses with activities abroad would be disadvantaged; they suggested that the legislation should be extended to include emissions certificates provided by car manufacturers under the law of other jurisdictions. Two of the respondents pointed out there could be a disparity between the CO_2 emissions figure available when a vehicle is ordered and the actual figure stated on the V5 and recommended that the vehicle’s CO2 data at the point of order be used for simplicity.

Lease Rental Restriction

Although the majority of respondents were satisfied that the legislation delivers the stated policy objectives, there was one particular area that eight respondents said could benefit from further consideration. Notwithstanding views favouring abolition, six of the respondents welcomed the option of removing the restriction for cars below the 160g/km CO_2 threshold. One respondent suggested that in its current form section *50A* on *short-tem hire and hiring to other business* may not operate as intended and would need to be expanded. In particular, the use of “short-term hire” could lead to certain sectors of the industry escaping the Lease Rental Restriction when the intention is that it should apply to all businesses.

CO_2 Thresholds

Three of the respondents also suggested that in future business should be given at least one year’s notice if there are changes to the CO_2 threshold, to allow time to make the necessary transitional adjustments and to avoid unintended consequences. One respondent pointed out that for cars above the 160g/km CO_2 threshold, a WDA of 10 per cent would be less than the commercial depreciation suffered.

Government response

The Government has updated the proposed legislation, in particular *Section 50A* on *Short-term hire and hiring to other business*, following the responses from stakeholders.

Glossary of terms

Car

For Plant and machinery allowances purposes a **car** is a mechanically propelled vehicle except a vehicle:

1. constructed in such a way that it is primarily suited for transporting goods of any sort, or
2. of a type which is not commonly used as a private vehicle and is not suitable for use as a private vehicle.

Expenditure Pool

Expenditure is pooled in order to calculate writing down allowances, balancing allowances and balancing charges. You pool expenditure by adding it together and deducting disposal values from the total. If the disposal values are more than the expenditure in the pool the difference is a balancing charge. There are no balancing allowances until the qualifying activity ends. When it does, the balancing allowance is equal to the unrelieved qualifying expenditure. [CA23210]

Vehicle Excise Duty (VED)

Every vehicle registered in the United Kingdom (UK) must be taxed if used or kept on a public road. For futher information please visit

Vehicle Excise Duty

http://www.direct.gov.uk/en/Motoring/OwningAVehicle/HowToTaxYourVehicle/DG_4022118

G/km

Grams per kilometre

First Year Allowance (FYA): Expenditure on cars with low carbon dioxide emissions

Businesses of all sizes can claim 100% FYAs on capital expenditure on a car provided that:

- the car is "unused and not second hand", and is first registered on or after 1 April 2008;
- it is an electric car, or
- a car with CO_2 emissions of not more than 110gm per km driven.
- the expenditure is incurred between **1 April 2008 and 31 March 2013.**

More related links

Consultation on modernising tax relief for business expenditure on cars: summary of responses

http://www.hm-treasury.gov.uk/pbr_csr07_cars.htm

Budget 2007: Modernising tax relief for business expenditure on cars: a consultation update

http://www.hm-treasury.gov.uk/bud_bud07_tax_relief_cars.htm

Modernising tax relief for business expenditure on cars: A consultation document

http://www.hm-treasury.gov.uk/bud_bud06_tax_relief_for_business_cars.htm