

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

Section 30 and Schedule 11: Tax Relief for Business Expenditure on Cars and Motor Cycles

Summary

1. **Section 30** and Schedule 11 make provision for the reform of the rules for tax relief for business expenditure on the purchase and hire of cars and motor cycles. The rate at which capital allowances can be claimed and the proportion of rental payments that may be deducted for tax will be determined by the carbon dioxide emissions of the car, rather than its cost as under the current rules. Motor cycles are taken out of the definition of a car for capital allowances and for the purposes of restricting the tax deduction for lease rental payments.

Details of the Schedule

2. This Schedule is in two parts; the first part details the amendments that are made to the Capital Allowances Act 2001 (CAA) in respect of the changes to the capital allowances rules. The second part details amendments to other Acts to effect the changes to rules restricting deductions for car hire expenses.

Part 1 - Capital Allowances

Plant and machinery allowances for cars and motor cycles

3. Paragraph 2 amends general exclusion 2 in section 38B of CAA, which states that expenditure on cars cannot qualify for annual investment allowance, by substituting the new definition of a car in section 268A of CAA for the old definition in section 81 of CAA. Section 81 of CAA (extended meaning of “car”) is repealed by paragraph 5 below.
4. Paragraph 3 substitutes the new definition of a car in section 268A of CAA for the old definition in section 81 of CAA in the second exclusion in section 46(2) of CAA which provides that expenditure on cars cannot be first-year qualifying expenditure.
5. Paragraph 4 repeals sections 74 to 79 of CAA (cars above the cost threshold). Sections 74 and 75 of CAA require that, if expenditure on a car exceeds £12,000, the expenditure be pooled in a single asset pool. Writing down allowances (WDA) are restricted to a maximum of £3,000 per annum.

Section 76 of CAA deals with contributions. It provides that where a person makes a contribution towards another party’s expenditure on a car costing more than £12,000, the person making the contribution can claim the WDAs. However, the available WDAs are restricted to a total of £3,000.

Sections 77 to 78 of CAA require that when a car is used for a non-qualifying purpose (e.g. private use) that the WDA is further restricted on a just and reasonable basis to

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reflect business use. On disposal of the vehicle any balancing charges/allowances are restricted in the same way.

Section 79 of CAA is an anti-avoidance measure that may apply in certain circumstances when cars (in single asset pools) are sold to connected parties.

6. Paragraph 6 substitutes the new definition of a car in the table in section 84 of CAA, which lists expenditure that cannot be treated as short-life asset expenditure.
7. Paragraph 7 amends section 104A (special rate expenditure) of CAA. Expenditure on cars which are not main rate cars, i.e. those with tail pipe emissions exceeding 160 grams of CO₂ per kilometre driven, qualifies for writing down allowances at the special rate of 10 per cent.
8. Sub-paragraph (2) amends subsection (1) of section 104A of CAA so that expenditure on or after the second relevant date on a car that is not a main rate car is treated as special rate expenditure.
9. Sub-paragraph (3) amends subsection (2) of section 104A of CAA for the introduction of a second relevant date.
10. Paragraph 8 inserts new section 104AA of CAA (meaning of “main rate car”). Generally it is a car with CO₂ emissions of 160 grams per kilometre driven or less, although all cars that were first registered before 1 March 2001 are main rate cars.
11. Paragraph 9 inserts new section 104F into CAA. This is to prevent the artificial generation of balancing allowances by groups of companies who engineer the cessation of a group company’s business of providing cars, only for another company in the group to continue a similar activity. It applies if conditions A, B and C are met.
12. New subsection (4) explains that condition C is that the company would otherwise be entitled to a balancing allowance in the special rate pool and that this balancing allowance would be greater than the total of any balancing charges less any balancing allowances in any other pools.
13. New subsection (5) explains that the balancing allowance that the company is entitled to in respect of the special rate pool, is limited to the balancing charges less balancing allowances arising on the other pools. This is so that a company will not be denied a balancing allowance on the special rate pool while at the same time bringing a balancing charge into account in another pool.
14. New subsections (6) and (7) explain that an amount equal to the balancing allowance, that the ceasing company would otherwise have been entitled to, will be treated as expenditure incurred by another company in the same group relief group, provided it carries on a qualifying activity of making cars available to other persons. This is the relevant company.
15. New subsection (9) explains that when the ceasing company’s penultimate chargeable period and the period in which the relevant company is treated as acquiring the expenditure overlap, the expenditure acquired is apportioned so that writing down allowances cannot be claimed by the relevant company for the overlapping period. This is to prevent writing down allowances on the expenditure being claimed by both companies for the same period.
16. Paragraph 10 inserts new section 208A into CAA. This is an anti-avoidance rule to prevent persons selling a car in a section 206 pool at undervalue in order to generate a balancing allowance.
17. New subsection (2) explains that a section 206 car is one that is allocated to a single asset pool because it is used partly for a purpose other than a qualifying activity.

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18. Paragraph 11 inserts new sections 268A, 268B and 268C (*Cars etc*) into CAA. New section 268A defines the terms “car” and “motor cycle”. New section 268B defines an electrically-propelled vehicle. New section 268C defines various terms relating to emissions.

Consequential amendments of CAA 2001

19. Paragraph 13 omits subsection (7) from section 33. This subsection explained that the extended meaning of “car” in section 81 of CAA did not apply to section 33, but section 81 is deleted by paragraph 3 above.
20. Paragraph 14 makes amendments to section 45D of CAA, which provides that expenditure on electric cars or those with CO₂ emissions of 110g/km or less qualifies for a first-year allowance. These cars still qualify for first-year allowance but the wording of the section has been changed to be consistent with new sections 268A and 268B of CAA.
21. Paragraph 16 amends section 55(6) of CAA (determination of entitlement or liability) so that a company is not entitled to a balancing allowance when the conditions in the anti-avoidance provision in the new section 104F of CAA are met.
22. Paragraph 18 amends section 66 of CAA (list of provisions about disposal values) to omit the reference to section 79 as it is being repealed; new section 208A of CAA is included.
23. Paragraph 19 sets out the consequential changes that are needed to the table in section 84 of CAA (which describes the circumstances where short-life asset treatment is ruled out) to reflect the new definition of hire cars for disabled people. Expenditure on hire cars for disabled people will still qualify for short-life asset treatment.
24. Paragraph 20 makes amendments to section 86 (short-life assets) of CAA. If the final chargeable period for a short life asset pool has not occurred before the four year cut-off, the balance of unrelieved expenditure on a car in a short life asset pool will be taken to either the main pool or special rate pool, depending on its CO₂ emissions.
25. Sub-paragraph (2) amends “main pool” in subsection (2)(b) to “appropriate pool” as some special rate cars may be short life assets.
26. Paragraph 22 inserts new section 268D into CAA. New subsections (1) and (2) define the meaning of a hire car for a disabled person and a disabled person. A disabled person is a person in receipt of the listed allowances or supplements (the list is unchanged from that in section 82(4) of CAA).
27. Paragraph 23 amends the defined expressions in Part 2 of Schedule 1 (defined expressions) to reflect the new definitions that are being introduced.
28. Sub-paragraph (3) adds a number of new definitions for the purposes of Part 2 of CAA .
29. Paragraph 25 repeals paragraph 6 in Schedule 19 to Finance Act 2002, that refers to cars in a single asset pool because of their cost, as a consequence of the changes being made by this Schedule.

Commencement and transitionals: introduction

30. Paragraphs 26 to 33 set out the dates and events from which the new legislation has effect by reference to “relevant dates”. They also provide transitional rules for expenditure incurred on cars and motor cycles before 1 April 2009 (for corporation tax) and 6 April 2009 (for income tax).
31. Paragraph 26 defines the “relevant dates” for income tax and corporation tax purposes.

32. Paragraph 27 explains the difference between “new expenditure” and “old expenditure” by reference to the relevant dates in paragraph 26. The amendments made by this Part of this Schedule (the new rules) have effect from different dates for old and new expenditure.

Commencement

33. Paragraph 28(1) explains that the amendments made by this Part of the Schedule apply only to new expenditure (as defined in paragraph 27 of the legislation). Sub-paragraph (2) provides that the new section 208A of CAA (disposal value in avoidance cases) will only apply where a person disposes of a car, the expenditure on which was new expenditure. Section 79 of CAA, which is repealed, will not apply to new expenditure.
34. Paragraph 29 explains that although sections 74 to 79 are repealed, the repeal is only effective for “old” expenditure for chargeable periods beginning on or after 1 (for persons within the charge to corporation tax) or 6 (for persons within the charge to income tax) April 2014.
35. Sub-paragraph (1) provides that the new rules do not apply to old expenditure until the first chargeable period beginning on or after the third relevant date (see paragraph 26); sections 74 to 78 of CAA will continue to apply to old expenditure until then.
36. Sub-paragraph (2) provides that section 79 of CAA does not apply to old expenditure for chargeable periods beginning on or after the third relevant date, but will apply to old expenditure until then.

Transitionals

37. Paragraph 30(1) applies where expenditure is incurred on a car and some of it is old expenditure and some is new.
- Sub-paragraph (2) provides that in these circumstances the expenditure must be treated as if it was on the provision of separate but identical cars or motor cycles so that the new expenditure is treated under the new (amended) rules and the old expenditure is treated under the old rules.
- Sub-paragraph (3) explains that when a person disposes of a car, in respect of which both new and old expenditure was incurred, the disposal proceeds must be apportioned between new rules pools and old rules pools on a just and reasonable basis.
38. Paragraph 31(1) explains how old expenditure, in a single asset pool by virtue of section 74 of CAA, is to be treated at the end of the transitional period, that is, in the first chargeable period beginning on or after 1 or 6 April 2014. Sub-paragraphs (2) and (3) provide that any unrelieved old expenditure is carried forward to the main pool and that this must be done in the first chargeable period beginning on or after 1 or 6 April 2014.
39. Paragraph 32 provides that any orders that may be made by the Treasury under section 82(4)(d) of CAA (in connection with payments to disabled persons) before the first relevant date and which are still in effect, have effect on and after that date as if they had been made under new section 268D(2)(d).

Part 2 - Restrictions on Deductions for Hire Expenses

40. The following paragraphs make a number of amendments to the Income Tax (Trading and Other Income) Act 2005 (ITTOIA), Corporation Taxes Act 2009 (CTA) and Income and Corporation Taxes Act 1988 (ICTA).
41. Paragraph 35 amends section 31(1)(b) to reflect the fact that motor cycles are no longer to be treated as cars.

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42. Paragraph 36 makes amendments to section 48 of ITTOIA which restricts the deductions from profits that may be made in respect of the costs of hiring certain cars.
43. Paragraph 36(2) deletes “or motor cycle” where it first occurs in section 48(1) of ITTOIA, so that motor cycle hire expenses are no longer restricted. It replaces sub-paragraphs (2)(a) and (2)(b) with new sub-paragraphs (2)(a), (b), (c) and (d) which describe the different types of cars to which the restriction does not apply under the new rules.
44. Sub-paragraphs (3) and (4) amend sections 48(2) and (4) of ITTOIA by deleting the existing formula used to calculate the reduction that is applied to the deduction for rental costs of leased cars that cost more than £12,000 when new, and replacing it with a flat rate 15 per cent reduction, that will apply in respect of cars that emit more than 160 grams of CO₂ per kilometre driven.
45. Sub-paragraph (6) deletes section 48(5) of ITTOIA (which gives the Treasury a power to amend by Order the calculation at section 48(3) of ITTOIA); this is no longer required as the old calculation has been replaced with a flat rate reduction.
46. Paragraph 37 makes various amendments to section 49 of ITTOIA, which defines the terms used in section 48, and inserts an additional definition.
47. Sub-paragraph (2)(c) inserts a new sub-paragraph 49(1)(za) before section 49(1)(a) of ITTOIA. This provides that a motor cycle, as defined by section 185(1) of the Road Traffic Act 1988, is not a car for the purposes of section 48 of ITTOIA. The effect of this is that expenses incurred on hiring a motor cycle do not fall within section 48.
48. Sub-paragraph (5) amends section 49(6) of ITTOIA which defines the word “new”, by deleting the words “and section 48”. This is because section 48, as amended, no longer uses the word “new”.
49. Paragraph 38 deletes section 50 (hiring cars with low carbon dioxide emissions) of ITTOIA. That section provides that cars with low CO₂ emissions are not subject to the lease rental restriction, but it is now incorporated into section 48(1) of ITTOIA.
50. Paragraph 39 inserts new section 50A into ITTOIA and new section 50B ITTOIA.
51. New section 50A provides that there is no restriction of allowable car hire expenses under section 48 of ITTOIA if the taxpayer meets one of two conditions, A or B
52. New section 50A(2) explains that condition A is met when the car is made available to the taxpayer for a period of 45 consecutive days or less. Hire periods of the same car may be aggregated for the purposes of determining the number of consecutive days.
53. New section 50A(3) explains that condition B is met when the taxpayer makes the car available to another person for more than 45 consecutive days. Hire periods of the same car may be aggregated for the purposes of determining the number of consecutive days.
54. New section 50A(4) provides that condition B is not met when the car is being provided to an employee of the taxpayer or of a person connected with the taxpayer.
55. New section 50A(5) is an anti-avoidance provision.
56. New section 50A(6) provides that where condition B is met for only part of a chargeable period, the taxpayer, when bringing the expenses to account, must apportion them between the parts of that period where the conditions are and are not met according to the respective lengths of those parts of the period.
57. New section 50A(7) provides that periods of consecutive days are amalgamated if the intervening period between them is not more than 14 days.
58. New section 50B provides that where two or more connected persons in a chain of leases would otherwise be required to apply the restriction to expenditure incurred on

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the hiring of the same car for the same period the restriction will apply to the superior lease in the chain provided it is on arm's length terms.

59. New section 50B(1) provides that section 50B applies to connected persons who incur expenses on the hiring of the same car for the same period who but for section 50B (or section 58B of CTA 2009) would have to apply a reduction to the expenses of car hire.
60. New section 50B(2) provides that this section does not apply if none of the persons in subsection (1) hire the car on commercial terms.
61. New section 50B(3) provides that where, but for this section, the reduction would apply to more than one connected person in respect of expenses incurred on the hiring of the same car for the same period, then the reduction will only apply once, and sets out how the reduction is to be applied.
62. New section 50B(4) provides that the reduction applies to all expenses incurred on the hiring of the same car by the same person; and "commercial arrangements" are such as would reasonably have been expected if the parties to the arrangements had been dealing at arm's length.

Corporation Tax

63. Paragraph 47 makes various amendments to section 56 of CTA 2009 (rules restricting deductions from profits: car or motor cycle hire) to mirror the amendments made to section 48 of ITTOIA detailed in paragraphs 42-45 of this note. Under the current rules there is a restriction in the amount of the expenditure incurred, in the hire of cars that cost over £12,000 when new, that a person can claim against their taxable profits. This system is to be replaced with a system based on the carbon dioxide (CO₂) emissions of cars, which applies a 15 per cent disallowance on expenses incurred on the hire/ lease of cars that emit more than 160 grams of CO₂ per kilometre driven.
64. Paragraph 48 makes various amendments to section 57 of CTA (car or motor cycle hire: supplementary). It also provides a number of supplementary definitions to section 57 CTA. These amendments mirror the amendments made to section 49 of ITTOIA by paragraph 37 as detailed in paragraphs 46-48 of this note.
65. Sub-paragraph (2)(c) inserts a new subparagraph 57(1)(za) before section 57(1)(a), making clear that a motor cycle, as defined by section 185(1) of the Road Traffic Act 1988, is excluded from the 15 per cent leasing reduction.
66. Paragraph 49 deletes section 58 (hiring cars with low CO₂ emissions before 1 April 2013) of CTA. That section provides that cars with low CO₂ emissions are not subject to the lease rental restriction, but is now no longer required as it has been incorporated into section 48(1) of CTA.
67. Paragraph 50 adds new sections 58A and 58B into CTA. The effect of sections 58A and 58B is to insert the same rules that are introduced in sections 50A and 50B of ITTOIA by paragraph 39 above into CTA. The purpose of section 58A is to provide that the restriction in section 56 does not apply to persons who enter into short term hire (for not more than 45 consecutive days) agreements, or to businesses that provide cars on longer term (more than 45 consecutive days) hire. Section 58B ensures that the restriction of allowable car hire expenses imposed by section 56 does not apply to more than one lessee in a chain of leases.
68. Paragraph 57 makes various amendments to section 1251 of CTA (car or motor cycle hire: companies with investment business). The effect of these amendments is that the rules for restricting the car hire expenses that may be deducted by companies with investment business mirror those for other companies in sections 56 to 58B of CTA.

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69. Paragraphs 60 and 61 amends sections 76ZN and 76ZO of ICTA so that the rules restricting the car hire expenses that may be deducted by insurance companies are the same as those for other companies, as detailed in paragraphs 63 to 67 of this note.
70. Paragraphs 62 and 63 amend the rules restricting deductions for car hire expenses in sections 578A and 578B of ICTA to mirror those in sections 56 to 58B of CTA.

Consequential repeals

71. Paragraph 64 sets out consequential amendments to FA 2008 and CTA 2009

Commencement

72. Paragraphs 65 and 66 set out the dates and events from which the new legislation takes effect by reference to relevant dates.
73. Sub-paragraph(1) of paragraph 66 provides that the new rules apply to deductions for expenditure incurred on the hiring of a car or motor cycle under an agreement under which the hire period begins on or after the first relevant date (but see paragraph 67). The first relevant date is 1 April 2009 (for corporation tax) or 6 April 2009 (for income tax).
74. Sub-paragraph (2) provides that for the purposes of this paragraph and paragraph 67, the hire period, in relation to an agreement, begins on the first day on which the car or motor cycle is required to be made available for use under the agreement.

Election for new regime not to apply in certain cases

75. Paragraph 67 provides for an election for the new regime not to apply in certain cases. Where a person entered into an agreement before 8 December 2008 for the hire of a car or motor cycle, but the hire period did not begin until after 1 or 6 April 2009, then the person may elect that the old rules restricting the deduction for the hire expenses under the contract will apply rather than the new. The hire period must, however, begin before 1 or 6 April 2010 for the election to apply. Sub-paragraphs (3) to (6) describe the procedure for the election.

Background Note

76. Depreciation of fixed assets charged in the commercial accounts of a business is not allowed as a deduction in computing the taxable profits. Instead capital allowances may be given at prescribed rates on certain assets, including plant and machinery. The annual investment allowance provides an annual 100 per cent allowance for the first £50,000 of investment in plant and machinery to all businesses. There are also certain 100 per cent first-year allowances available for certain types of expenditure (such as expenditure on qualifying energy-saving plant or machinery). Otherwise expenditure on plant and machinery assets attracts a writing down allowance (WDA) calculated on a reducing balance basis. Qualifying expenditure has to be pooled for the purpose of determining entitlement to writing down allowances. WDA for assets in the main pool is 20 per cent (of unrelieved expenditure in the pool) per annum. The special rate pool was introduced from April 2008 with a WDA rate of 10 per cent.
77. Cars are plant and machinery, but there are special capital allowances rules that apply only to cars. The existing rules are based on the cost of the car:
- expenditure on cars with very low carbon dioxide emissions (up to 110g/km) can qualify for 100 per cent first-year allowances, so that the full cost of the car is written off against profits in the period that it is incurred;
 - expenditure on cars costing £12,000 or less is allocated to the main pool and WDAs are given at 20 per cent per annum on the reducing balance of expenditure; and

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- expenditure on cars costing over £12,000 must be dealt with separately from expenditure on other assets with expenditure on each car being allocated to a single asset pool. The WDAs are calculated in the normal way (at 20 per cent) and then restricted to an annual amount of £3,000. However, when the car is sold any unrelieved depreciation is allowed through a balancing allowance, while any excess allowances over economic depreciation are recovered through a balancing charge.
78. Expenditure on cars that are partly used for non-business purposes is also allocated to a single asset pool to enable an adjustment to be made to restrict the WDA for the proportion of business use of the car (the “private use” adjustment).
79. Certain cars (qualifying hire cars- including cars used as taxis, daily hire cars and cars leased to the disabled) are exempt from the current rules for cars costing over £12,000. Expenditure on such cars is dealt with in accordance with the capital allowances rules for other plant and machinery. Motor cycles are within the capital allowances definition of a car and are therefore subject to the rules for cars.
80. Not all businesses buy their cars but instead hire (lease) them. There are rules that restrict the tax deduction for hire expenses where the car cost more than £12,000. The amount of the lease rental payments that would otherwise be allowed is reduced using a formula or fraction which is based on the retail price of the car when new. This is commonly known as the lease rental restriction (LRR). Every business lessee in a chain of leases is potentially subject to the LRR.
81. The capital allowances rules for cars were originally introduced as a surrogate benefits charge on luxury cars, but the rules are now seen by business as outdated (in today’s market more than half of business cars cost more than £12,000) and onerous to comply with. Maintaining separate capital allowance pools for each expensive car is considered to impose a disproportionate compliance burden. This Schedule provides for the reform of these rules that business has pressed for, as announced at Budget 2008. The new rules are designed to fit with the Government’s environmental objectives in that they aim to encourage businesses to use cars with lower carbon dioxide emissions. The allowances to which a business is entitled will now be governed by the car’s carbon dioxide emissions rather than its cost.
82. The new capital allowances rules for cars generally apply to qualifying expenditure incurred on or after 1 April 2009 for businesses within the charge to corporation tax or 6 April 2009 for businesses within the charge to income tax. 100 per cent first-year allowances continue to be available on cars with very low carbon dioxide emissions (until 31 March 2013) but expenditure on other cars will be allocated to one of the two plant and machinery pools.
83. The appropriate pool is determined by the car’s carbon dioxide emissions. Expenditure on cars with carbon dioxide emissions exceeding 160g/km will be allocated to the special rate pool while expenditure on cars with emissions of 160g/km or less will be allocated to the main rate pool. Cars that are partly used for non-business purposes will continue to be allocated to a single asset pool to enable a private use adjustment to be made, but the rate of WDA will depend on the car’s carbon dioxide emissions.
84. Expenditure incurred before April 2009 will continue to be subject to the old rules for a transitional period of around five years. Any expenditure remaining in a single asset pool (unless there is any non-business use of the car) will be transferred to the main capital allowances pool at the beginning of the first chargeable period to commence on or after 1 or 6 April 2014.
85. For leases that commenced on or after 1 or 6 April 2009, the special rules that restrict the amount of lease rental payments that can be deducted for tax purposes for a car costing over £12,000 will be similarly reformed. The restriction will be changed to a flat rate disallowance of 15 per cent of relevant payments and will apply only in respect of cars with CO2 emissions above 160g/km.

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86. From April 2009 the LRR will apply to only one lessee in any chain of leases. Broadly, businesses will not be subject to a restriction of their allowable lease rental payments where the car is made available to them for a period of no more than 45 consecutive days. Also a business will not be subject to LRR in respect of expenses it incurs in hiring a car where it makes the car available to a customer for a sub-hire period of more than 45 consecutive days (this exclusion does not apply, however, where a business makes cars available to its employees or the employees of a connected person).
87. Leases that commenced before 1 or 6 April 2009 will continue to be subject to the old rules for the duration of the lease.
88. Hire cars (cars used as taxis, daily hire cars and cars leased to the disabled) that are exempt from the current rules will be fully included in the new rules. However, motor cycles will be excluded from the definition of cars and will not, therefore, be subject to these rules. Expenditure incurred on motor cycles on or after 1 or 6 April 2009 will qualify, where appropriate, for Annual Investment Allowance, first year allowances and to be treated as short life asset expenditure.
89. The changes made by this Schedule represent a simplification of the rules for most businesses (by a reduction in both the numbers of cars in single asset pools and the number of leases that are subject to LRR) and will therefore reduce compliance costs. The changes are part of a package of measures to encourage businesses to choose cars that emit lower levels of carbon dioxide.