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What to consider when deciding to either lease or purchase a vehicle

An important decision for any business when deciding to acquire or replace a vehicle is whether to purchase it using money from the business or via finance or whether to enter into one of the many forms of leasing agreements.

In addition to the financial terms offered, it is important to consider the different tax implications of leasing versus buying.

The main tax issues to be considered include:

- The extent to which any financial outgoings are tax deductible and the timing of the related tax relief.
- The extent of any personal tax liabilities where the vehicle is available for private use by a director or an employee.
- The extent of any tax implications relating to the disallowance for private use where the vehicle is owned or leased by a sole trader or partnership.
- The extent to which the VAT charged on the purchase cost or leasing payments is recoverable. In most cases the business will of course already be VAT registered.

Outright Purchase

As the business normally owns the vehicle from the outset then tax relief is available to the business on the purchase cost via capital allowances.

- Where the vehicle is classified as a motorcar or where the business is not VAT registered then the capital allowances will be based on the VAT inclusive cost.

- Where the vehicle is classified as a commercial vehicle then for VAT registered businesses the input tax is recoverable so the capital allowances are based on the VAT exclusive cost.

The current capital allowances rates for vehicles for 2016/17 are as follows:

- Commercial Vehicles ~ 100% of qualifying cost (as part of the Annual Investment Allowance, currently £200,000 per year.
- Motor cars where the CO2 emissions do not exceed 75 grams/km ~ a 100% First Year Allowance is available.
- Motor Cars where C02 between 75 and 130 grams/km ~ 18% allowance per annum on a reducing balance basis.
- Motor Cars where C02 is greater than 130 grams/km ~ 8% allowance per annum on a reducing balance basis.

Leasing Options

There are numerous types of 'leasing' contracts available to businesses and a detailed consideration of these is outside the scope of this article. Two of the main options available are 'contract hire' or a 'finance lease':

- Contract Hire (also known as an 'operating lease') - under this type of contract the lease rentals are written off for tax purposes against profits as they are incurred. Unlike a finance lease, the asset is not capitalised in the balance sheet as the business is simply hiring a vehicle for a contracted period.

- Finance Lease - Under this option a business is not treated as owning the asset and cannot claim capital allowances. However in order to comply with generally accepted accounting practice it should be capitalised as a fixed asset with the annual depreciation charge plus any interest payable under the lease claimed as an allowable deduction for tax purposes.

Note that where a car is leased AND has a CO2 emission of greater than 75 grams/km then only
85% of the leasing costs are tax deductible

For leased cars with private use the business may only recover 50% of the VAT on the lease payments (assuming the business is registered for VAT).

<u>Personal tax implications</u>

- Where a motor car is acquired or leased by a limited company and is available for private use by a director or employee, a taxable benefit liable to income tax plus a liability to employer Class 1A NIC will arise. The taxable benefit is based on a combination of the list price and the CO2 emission of the car. If private fuel is provided there is an additional fuel benefit also based on the CO2 emission of the car.

- For commercial vehicles the taxable benefit is based on a fixed scale of £3,170 per annum, unless the private use is insignificant in which case it is treated as an exempt benefit. If fuel for private use is also provided then there is an additional taxable benefit of £598 per annum.

- Where a vehicle is used privately by a business proprietor (i.e. a sole trader or partner) all of the relevant tax deductions, such as capital allowances, lease payments and interest charges etc must be restricted accordingly by the % of private use. This has the effect of increasing the taxable profit on which income tax and Class 4 National Insurance Contributions is payable.

Other factors which need to be considered in reaching a decision include:

- Whether the vehicle is to be owned/leased by a limited company or as a sole trader / partnership.

- Estimated mileage ~ generally high mileage vehicles can be penalised under leasing contracts.

- The various types of lease agreements which are currently available. A finance lease normally has an option to purchase the vehicle at the end of the initial lease term.

- Under 'contract hire' ~ the extent of the lessor's obligations regarding certain costs such as servicing, road fund license etc. Where a vehicle is provided under a finance lease or purchased outright then these type of running expenses will be the responsibility of the business itself.

- Where the vehicle is to be purchased ~ the extent to which some type of finance is required, such as a Hire Purchase (HP) agreement. In the case of a HP agreement, although installments are made over a period of years, capital allowances are normally available on the normal 'cash price' commencing with the period in which the deposit is paid. Commercial vehicles (or cars with low CO2 emissions of 75 grams/km or less) acquired on HP qualify for an immediate 100% tax deduction. The interest element of each installment is tax deductible against profits over the term of the HP agreement. Note that the legal title of the vehicle remains with the HP company until the final installment has been paid.

For further information or advice on acquiring a new vehicle please phone inBOS on 01543 624 036 or email: accounts@inbos.co.uk.