

The Last Gas-Guzzler – Changes in the Rules for Capital Allowances on Cars



This article looks at the new rules for capital allowances on cars bought by businesses. There has been a long consultation process and the new rules were announced in the Pre Budget Report, followed up by a "Technical Note" which dealt with the details of the new regime. In order to understand the changes, we should first review the rules as they were before the changes that have been announced. We can then look at some planning points that arise.

The Current Rules

Capital allowances are given on "plant and machinery" purchased by a business to use in its trade.

Most such capital expenditure goes into a "pool", and allowances are calculated based on the size of the pool for the year after taking into account the cost of new additions and the sale proceeds of disposals.

Cars costing more than £12,000 are excluded from this pool, and each car has its own separate pool for capital allowance purposes. The same applies to any car which is used for non-business purposes to any extent, so in the case of a partnership or sole trader, this will apply to virtually every car they buy.

Capital allowances are given by "writing down" the amount in the pool by 25% (before April 2008) or 20% (now) per year, and in the case of cars this WDA is limited to a maximum of £3,000 per year. There is then an adjustment (mostly for income tax cases, not for limited companies) to reflect non-business use of the vehicle.

When the car is sold, the sale proceeds are deducted from the expenditure left in the pool for that particular car, and any remaining expenditure is relieved as a "balancing allowance" deducted from the profits of the year concerned. Given that most, if not all, new cars depreciate in value faster than 20% per year, there will typically be a significant "balancing allowance" for the year in which the car is sold.

The New Rules

For cars bought after 1 April 2009 (companies) or 5 April 2009 (sole traders and partnerships), the rules are very different. The rate of capital allowances on a car will depend on its CO2 emissions. Cars emitting more than 160 g/km will attract a writing down allowance of only 10%, whereas those emitting 160g/km or less will be entitled to the 20% rate.

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Our mission is to always add value whatever we do for you. We will always carry out our work with the aim of adding value to your business.

This newsletter is designed to ensure you are kept up to date with the latest tax advice. This ensures you are provided with the most up to date information to enable you to stay ahead of the game.

As tax advisers, our objective is to work closely with you to ensure you pay the minimum tax required by law. We will help you understand the tax implications of your actions, in order that you can plan ahead and conduct your affairs in the most tax efficient way.

Please do not hesitate to contact us if you have any queries.

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Crucially, the idea of separate pools for each car costing over £12,000 will also be scrapped. Cars will either go into the 20% pool with other normal plant and machinery, or into the 10% pool with such items as "long-life" assets and "integral" fixtures in buildings.

The only exception to this will be cars which are used privately to some extent, as these will each need to be in a separate pool of their own to enable the adjustment for such use to be made. This means, as we shall see, that the changes will have different effects on companies to those they will have on sole traders and partnerships.

Leasing

If a business leases its cars rather than buying them, there is currently a disallowance of some of the leasing charges, based on the £12,000 cost limit. For cars leased from April 2009, this will change and there will be a flat rate disallowance of 15% for cars emitting over 160g/km, but there will be no disallowance for the "greener" cars emitting 160g/km or less.

"Grandfathering"

This term is used in the tax world to refer to a situation where there is a fundamental change in the rules but the old rules are still applied to expenditure incurred before a certain date. For limited companies, expenditure on cars before 1 April 2009 will be "grandfathered" so that the old rules will apply, and the same applies to expenditure incurred before 5 April 2009 by partnerships and sole traders – though as we have seen, because there is almost always private use of partnership/sole trader cars, the effect on them will be less dramatic and grandfathering will be less significant.

Sadly, like all grandfathers, this one has a limited life expectancy, and in five years' time, any expenditure in individual pools dating from before April 2009 will be transferred to the general 20% or 10% pool.

Tax Planning – Companies

The key thing about the current rules is that when a company sells a car, because that car has its own pool, there will be a deduction for the full cost (the difference between the purchase and sale price) in the form of a balancing allowance in the year the car is sold.

Under the new rules, this will not occur, because the car will be in a pool with all kinds of other assets, and so there will be no balancing allowance. The company will still be getting writing down allowances at 10%

or 20% on the cost long after the car in question has been sold. Whether the company intends to buy a "green" car or a gas guzzler, it will probably be beneficial to do so before 1 April 2009, simply because of this one fact. The more expensive and the "dirtier" the car, the greater will be the difference in the timing of allowances. If a company buys a new car now and sells it after three years, it will get less than half what it paid for it and the difference will be tax relieved by a balancing allowance. If it waits until after 1 April to buy the car, then at the end of the third year there will be no balancing allowance because the car is in the pool with all the other capital items.

In the case of leased cars, however, the opposite applies. If the car to be leased costs more than £12,000, or in the case of a gas guzzler over 160g/km, about £17,000, then it will be beneficial to wait until after 1 April to change cars.

Tax Planning – Sole Traders and Partnerships

In almost every case there will be some private use of cars bought by these entities,

so as each car will continue to have a separate pool of its own, the balancing allowance will still be available on sale as described above. The limit of £3,000 on the writing down allowance on cars costing more than £12,000 will go, so if you are planning to spend more than that on a car it will be beneficial to wait until after 5 April 2009 to buy it.

In the case of leased cars, the position is the same as with companies – it will be better to wait until after 5 April in the case of any car costing over £12,000, and in the case of gas guzzlers, over £17,000.

There is a rather good recession joke going around:

Q: What's the difference between a financier and a seagull?

A: A seagull can still put a deposit on a Ferrari!

Those out there who can still afford Ferraris will need to think carefully about the timing of the purchase, depending on what sort of entity they trade through.

Q&A

Q.1. Through my company I paid a franchise signing-on fee of £15,000 five years ago (it was entirely a "fee" as training and other up-front costs were on top of this and were written off). I have not renewed my franchise after the five year contract was up this July. The £15k is still sitting on my balance sheet as an intangible asset but I believe it has no value as it has never been amortized, since I made losses and never needed to pursue any tax relief on this.

Can I now write it off and will I be able to get any tax relief for it?

A.1. Provided the franchise was acquired after 1 April 2002, by a limited company, it falls within the "Corporate Intangibles" regime introduced by the 2002 Finance Act and yes, in principle the company can claim a deduction for it. The detail is very complex and you should speak to your accountant or a tax adviser.

Q.2. I am a LGV driver and I spend more time abroad than here in the UK. Am I entitled to reclaim my tax? Friends who work on the boats from Dover to Calais reclaim their tax each year as they are officially out of the UK for more than six months of the year.

A.2. This is an extremely complicated issue and depends on a number of factors

as well as the time you spend in and out of the UK. You need to consult a tax adviser.

Q.3. If I pay my staff's professional subscriptions, how much can I claim back from the IR?

A.3. You can claim the cost of the subscriptions as a business expense, and provided the institutions concerned are on the list of approved organisations published by HM Revenue and Customs ("List 3"), the payments will not be taxable as benefits in kind on the employees. You should consult a tax adviser about getting a "dispensation" from HMRC so that you do not have to report these payments.

Q.4. Are expenses i.e. hotel, food and drink, taxable expenses? Also, is a one-off bonus classed as taxable income?

A.4. The rules for expenses are very complicated, but very broadly, if you are on a business trip away from your usual place of work then the cost of accommodation and subsistence is an allowable expense.

A "one-off bonus" is almost certainly taxable, though in certain, very unusual, circumstances it might not be. Once again, I need more information to be sure.

Back to the Future – Temporary Extension of Scope for Carrying Back Trading Losses

Gordon Brown's Pre Budget Report – delivered, as usual, by his mouthpiece Alastair Darling – included a temporary extension of the right to claim tax relief for trading losses against previous years' profits.

The normal rules allow you to carry a trading loss back to the previous year and (assuming there were taxable profits in that year) to claim a repayment of the tax charged on them. The new temporary extension allows a three year carry back, but the details are significantly different depending on whether your business is conducted through a limited company or not.

Limited Companies

A limited company is charged to corporation tax on its profits, which include trading profits, investment income, and chargeable gains. Under the present rules, a trading loss is first set against the other income of the accounting period in which it arises, and if there are losses still unrelieved, these can either:

- Be carried forward against future profits of the same trade, or
- Be carried back to the previous accounting period and set against the company's profits for that period – note that "profits" includes profits from all sources, including chargeable gains.

The temporary extension allows those losses to be carried back and set against the profits of the previous three accounting periods, but there are certain restrictions:

- There is no limit to the amount of loss that can be relieved against the preceding accounting period – except of course that the amount carried back cannot be greater than the profits of that previous period.
- Only if there are further losses after relief against the previous period can they be carried back to the year before, and only after all the profits of that year have been reduced to nil can any remaining losses be carried back to the year before that.
- There is a limit of £50,000 on the losses that can be carried back to the "extra" two years before the one immediately before the loss making period.
- The extended relief is only available for losses of an accounting period that ends between 24 November 2008 and 23 November 2009. For a company with a

normal 12 month accounting period, this will therefore mean only one accounting period will benefit from the extended carry-back.

- There are special rules to deal with companies which have accounting periods shorter than one year.

Unincorporated Businesses

Partnerships and sole traders are also offered the extended carry-back but it is less generous. The losses can only be carried back against profits of the same trade, in contrast to the corporation tax losses which can be offset against all of the company's profits as described above. The details of the carry-back for income tax businesses are:

- The loss that can be carried back for the extra two years is that for the tax year 2008/09.
- As with corporation tax losses, the loss is first carried back to the previous year (2007/08), and only once the trading profits of that year have been covered can any remaining losses (again subject to the £50,000 limit) be carried back to set against the trading profits of 2006/07, and if there are still any left, against those of 2005/06.

Other Loss Relief

There are other forms of loss relief available and in some cases these will be preferable to the new and temporary one described above, particularly if the trade concerned is ceasing:

- Companies can carry a loss arising in their final year of trading back against all profits of the previous three years (assuming the same trade was carried on during that period), and the £50,000 cap does not apply in this situation.
- Unincorporated businesses can do the same carry-back for three years preceding the year of cessation, but only against the profits of the same trade.
- Unincorporated businesses (but not companies) can also get extended relief for losses arising in their first four years of trading. Such losses can be carried back against all income of the three years preceding the year in which the loss is made, not just the losses of the same trade. Once again, the £50,000 cap does not apply.

Tax Planning

It remains to be seen how many businesses will be able to claim the new extended loss

Tax Tips

- If you sell your business, will you qualify for Entrepreneur's Relief, which can reduce the rate of tax on the first £1million of capital gains from 18% to 10%? Don't assume that because you qualified for Business Asset Taper Relief before this was abolished by FA 2008, you will qualify for Entrepreneur's Relief now – the rules are very different and much more restrictive.
- There is much excitement about whether retailers will pass on the benefit of the 2.5% cut in VAT to their customers, but no one seems to be asking if banks and other financial institutions will do the same with the much bigger real cost savings the VAT cut will bring to them. Such businesses are "exempt" or "partially exempt" from VAT, which means they cannot recover the VAT on all or most of their business expenditure, so in broad terms the VAT reduction has reduced all their costs except payroll by about 2%.
- Do you have 50 or more employees? Don't forget that you will have to file PAYE returns for 2008/09 online, and if you have not already done so, either get your own system set up or get signed up with an external provider well before the 19 April 2009 deadline.
- Have you made any Gift Aid payments to charity since 5 April 2008? If you wish, when you file your 2007/08 return you can ask for these to be treated as having been made in the tax year 2007/08.

relief, and how many will want to. In many cases the existing reliefs are better value, but there may be some cases where the temporary extension will enable relief to be claimed where it would not be available under the normal rules. Tax planning will involve three main thought processes:

- Changing accounting dates (both for companies and income tax businesses) in order to maximise relief.
- Choosing between the various reliefs available for a specific loss – this has always been an important part of loss relief management, and for one year, there will be yet another choice to consider.
- Timing of expenditure on both revenue and capital items to seek to maximise the losses of the accounting period falling into the temporary extension of relief.

A Pilot Scheme – Trusts and the Inheritance Tax Nil Rate Band

Inheritance Tax (IHT) tends to be thought of as a tax payable on death, but it also rears its head during your lifetime, in the form of “chargeable lifetime transfers”, and it does not only affect individuals because most trusts also suffer a charge to IHT every ten years.

A “chargeable lifetime transfer” occurs when you make a gift into a trust. An outright gift to an individual is a “potentially exempt transfer” (PET), and provided you survive it by seven years it drops out of account for IHT purposes. If you die within this seven year quarantine period, the PET becomes a chargeable transfer and is included in the calculation of IHT on your death.

A transfer to a trust, however, is immediately chargeable to IHT. You can take account of your nil rate band (currently £312,000), but if your “cumulative total” of chargeable transfers in the previous seven years is more than that, the rest is charged to IHT at the “lifetime rate” of 20%.

In this article I want to concentrate on a technique for reducing the IHT charges suffered by the trust itself, rather than by the individual who set it up. Since the changes in the 2006 Finance Act, most trusts these days are “relevant property” trusts, which means that they are themselves liable to IHT.

There are two types of IHT charge on a trust. There is a “principal charge” on the tenth anniversary of the creation of the trust and every ten years thereafter, and there is a “proportionate charge” in between these principal charges every time capital (not income) leaves the trust by being passed out to a beneficiary.

The calculation of both these charges is hideously complicated, but the starting point is the amount of the nil rate band available to the trust. If it has the full £312,000 available to it, and the capital in the trust (or

in the case of a proportionate charge, the capital leaving the trust) is less than £312,000, then there is no IHT to pay. The amount of the nil rate band available to the trust is calculated by taking the current nil rate band, and then deducting all the chargeable transfers made by the same “settlor” (the person who put the capital into the trust) over the seven years before the trust was set up. Other chargeable transfers made on the same day are included in this total. Remember that point – you will see its importance in a minute!

It is quite common for a trust to be set up by a person’s Will. Assuming that the individual concerned has an estate worth more than the £312,000 nil rate band, then it is quite likely that the trust will have no nil rate band available to it because it has been used up by the chargeable transfer of all his wealth deemed to occur at the date of death. This will mean that when the tenth anniversary comes round, or when property leaves the trust before that date, the IHT payable will be increased because the trust will have little or no nil rate band to set against the value to be taxed. In a worst case, the maximum IHT liability will be 6% of the value of the trust’s assets.

This is where “pilot trusts” come into their own. Instead of setting up the trust by way of the Will, the trust is set up during the person’s lifetime, with a nominal amount of capital (say £10). Assuming the person involved has made no previous chargeable transfers, the trust will therefore have the whole nil rate band available to it. Subsequent additions to the trust do not change this position, so when the person dies, they can leave significant wealth to the trust and this will not alter the amount of nil rate band available to the trust when the tenth anniversary comes round.

In some cases, a person may want more than one trust set up. If so, the second trust is set up the day after the first one, also with a nominal £10. This second trust will have a

nil rate band available to it of £312,000 minus the £10 put into the first trust. To take a different example, if you want to set up a trust with £100,000 for the benefit of your (adult) children during your lifetime, and to leave your assets in trust for your grandchildren when you die, you set up a “pilot trust” for the grandchildren on Monday, and then set up the lifetime trust for your children on Tuesday. If you do it the other way round or do both on the same day, the grandchildren’s trust will have its nil rate band reduced by the £100,000 that went into the lifetime trust for the children. You then leave the assets for the grandchildren in your Will to the pilot trust.

The key point is that the trust’s nil rate band is determined on the day it is set up, and does not alter when subsequent transfers are made to it.

This technique will not reduce the IHT payable on the death of the individual concerned, but it will reduce the IHT payable later by the trusts themselves on their tenth anniversaries or when property is transferred out.

Setting up “pilot trusts” is a job for an expert, as there are several procedural pitfalls to beware of. For example, the £10 must actually be received by the trust, because in law a trust only comes into being when it receives property. It is quite a common practice to keep a £10 note on the trust file to prove it was received by the trust at the time it was set up. It is also important that the trust is set up before the Will is signed, so that the Will can leave the assets concerned to a trust that is already in existence.

There is no substitute for proper professional advice if you are considering using a pilot trust. A solicitor who specialises in Wills, or a properly qualified tax adviser, will be able to talk you through the fine detail that must be got right if the pilot trust is to achieve its objective.

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