Funding your Company Cars

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Introduction

There are two main routes to vehicle acquisition: you either own the vehicle outright or hire the use of it over a fixed period through a leasing arrangement.

Regular industry surveys, including the annual Fleet News FN50, the in-depth guide to the 50 largest contract hire companies in the country, show that more than half of all new company cars registered each year are funded through contract hire – and that figure is growing.

There are many reasons for this, not least of which is the fact that contract hire offers simplicity and convenience for the operator and a sound basis for reliable cost forecasting.

Effectively, the fleet is managed by an outside specialist, with the customer paying a fixed monthly charge which may include all maintenance costs. At the end of the agreed operating period, the contract is terminated and the car is handed back to the leasing company.

It sounds easy enough, but, as any fleet manager knows, when drivers are added to the equation things can become more complicated, particularly when staff turnover, accident damage and general 'wear and tear' are taken into account.

Across a large fleet, these associated costs can often undermine the benefits of opting for contract hire to control operating costs in the first place, so careful thought needs to go into selecting contract hire as the most cost-effective funding method.

This Guide to Leasing and Contract Hire shows how a focus on best practice and effective driver monitoring can mean contract hire is one of the best ways to run an efficient fleet operation that delivers real value for money.

Purchase or lease?

Compared with the British car parc as a whole, the fleet sector is noticeably ahead of the retail sector in the adoption of lower-emission cars, driven mainly by fiscal incentives and, particularly, the need to cut Benefit in Kind tax.

According to figures from the British Vehicle Rental and Leasing Association, the average CO_2 emissions of leased cars, which make up the majority of the three million or so company cars on our roads, have reduced from 149.9g/km in 2008 to 144.0g/km in 2009.

This outstrips the decrease across total new car registrations: Society of Motor Manufacturers and Traders figures show that in 2008 the average CO_2 emissions for new cars was 164.9g/km.

Yet there is still some way to go before CO_2 emissions reach the target the European Parliament will introduce – a 125g/km average for all new cars by 2015.

The relatively green track record in the fleet sector does not mean does not mean legislation will continue as it is, however.

The new emissions-based vehicle excise duty regime which came into force in April 2009 provides a glimpse of the Government's determination to reduce emissions from cars – see 'Emissions-based legislation' below. The scheme continues to tighten legislation based on CO_2 emissions.

Tax benefits explained

Changes in the tax treatment of contract hire have played an important part in its popularity.

Since VAT was introduced, special rules have applied to car purchases, but major changes implemented on 1 August, 1995, had the greatest impact. Prior to this date, lease rentals included the leasing companies' own input VAT which could not be recovered; the customers' VAT liability was added to the total rental.

When the changes were introduced, companies which could show their vehicles were used exclusively for business use were able to recover VAT in full when buying cars.

This immediately meant that leasing companies, which have no private use of vehicles – it is their customers who do – could acquire vehicles for less, even before their volume discounts were taken into account. The advantages were obvious when compared with an outright purchase fleet where vehicles were available for employees' private use. As a result, the number of vehicles funded through contract hire has rocketed over the past decade.

From 1990 to 1994 the contract hire fleet size of British Vehicle Rental and Leasing Association members fell from 658,559 cars to 567,027, but since the 1995 VAT rules were implemented it has since risen steadily. In 1995 the figure was 572,501; it broke through the one million mark in 2000, while for 2009 the total was quoted at 1,664,003.

The tax treatment of contract hire
The VAT on lease rentals is fully recoverable, subject to normal VAT rules, if the vehicle is used entirely for business purposes. However, only 50% of the VAT on the rentals is recoverable if there is any private use.

When expenses such as maintenance and repairs are incurred by a business on a leased car, VAT on these costs is fully recoverable.

If contract hire charges include maintenance and other additional services, the 50% restriction to VAT recovery applies only to the 'basic rental' element of the charge. This includes depreciation, funding costs, VED liabilities and a proportion of the overheads, risk and profit, plus the funding of any options or accessories fitted before delivery.

The charge for additional services must be at market value. Provided customers have a choice of whether or not to opt for additional services such as maintenance, repair and roadside assistance, 100% of the VAT on these services is also recoverable.

The services element subject to 100% VAT reclaim could include charges for tyres and exhaust replacement, along with overheads, risk and profit on these services.

Capital allowances
The capital allowance treatment of company cars was reformed to favour those with low CO_2 emissions with effect from April 1, 2009, for corporation tax and April 6, 2009, for income tax.

Existing cars on-fleet at these dates continue under the previous regime, based on price, until disposal, with a likely switch-over period of five years imposed from the date of inception of the new system.

Under the emissions-based rules, new company cars with CO_2 emissions of 111–160g/km inclusive attract a 20% write-down allowance (WDA), while those with emissions above 160g/km attract only a 10% WDA.

As with the previous system, a 100% first-year allowance applies to cars with emissions of 110g/km or less, with this allowance applicable until March 31, 2013.

Electric vans have qualified for a 100% first year capital allowance since April 2010, joining electric cars which have received the allowance since 2002.

Leasing disallowances (lease rental restriction)
Leasing disallowances also changed, with the introduction of a new emissions-based system. New cars with CO_2 emissions of 160g/km or less are eligible for 100% of their lease payments to be offset against corporation tax.

The rules which disallow a proportion of car lease rental payments have also been reformed in line with the new capital allowances rules, with the new disallowance set at 15% of the relevant payments, applied to cars with CO_2 emissions of 160g/km or more.

Assessing your requirements

The principles of contract hire are the same wherever you look; it is the service and added value benefits that distinguish individual suppliers.

To get the most out of a leasing company, it is important to understand the profile of your fleet and how it will be used, ensuring a supplier is selected who can offer the right services to manage cost and efficiency.

For example, does the leasing company have facilities to cater for any specialist vehicle equipment you might operate? Is an internet-based service required or is personal service more important?

One of the biggest growth areas in terms of added value service provided by a leasing supplier has been risk management. As fleets look for advice and support on the ever-increasing burden of human resources and legislation, leasing companies have been quick to introduce additional services that help fleets cut accidents and costs. Services range from licence checking and online driver assessment to full-blown driver training, provided through third-party suppliers.

Some leasing companies can also offer vehicle tracking to customers to help them keep a closer eye on their vehicles.

In many cases, these costs can be rolled into the monthly lease rates for vehicles or a separate charge can be agreed.

Managing hidden costs

Fleet operators choosing suppliers offering the lowest lease rates could end up paying the highest charges at the end of the contract. Additional charges on lease vehicles can include pence-per-mile costs for excess mileage or the cost of vehicle refurbishment because it has not been looked after properly by drivers.

The amounts that leasing companies charge can vary significantly, and fleet decision-makers need to look closely at their contracts and quotes to ensure they are comparing suppliers on a level playing field.

Experts believe the majority of fleets will simply chase the lowest possible headline lease rate even though these are almost always accompanied by the highest out-of-contract charges.

The problem is that many fleets simply accept these charges when they are incurred, even if the bill they receive from their leasing company runs to thousands of pounds.

Fleets can put a number of policies in place to avoid this situation. These might include tracking the actual cost of leasing a vehicle, taking into account all associated costs and not simply the monthly rate.

Check details precisely when comparing figures such as the initial payment is also vital: ensure it's a like-for-like comparison.

Similarly, is there a charge for extras that some competitors might include for free, such as a dedicated support line for drivers?

Watch out for high excess mileage charges – some companies may offer low rentals but offset this with high charges for excess mileage. They also won't allow you to pool mileage. Make sure you compare these before signing up. Also, is there a flexible approach towards costs? Some leasing companies now simply absorb charges under £50.

Finally, how much will your leasing company charge for handling drivers' fines, as this can bring hefty unexpected costs.

When less is more
It isn't just the type of car you buy, but the badge you opt for that will make a difference to your rates.

Residual values and holding costs dictate how much a vehicle will cost to lease, so it pays to consider your options before assuming that cheapest it best.

As a general rule, prestige brands with strong residual values will generate more competitive lease rates.

A guide to lease rates is provided by Fleet News at www.fleetnews.co.uk, which also offers a guide to how much in cost per mile terms every car in the UK costs to run.

The guide reveals that an Audi A3 Sportback 2.0 TDI 140PS Sport with a P11D value of £21,410 should cost around 31p/mile to run over 3yrs/60,000 miles.

By contrast, a Ford Focus 2.0 TDCi Titanium 5dr with a P11D value of £20,690 would cost around 35p/mile to run: the higher rate illustrates the greater depreciation suffered compared with the Audi.

Source: Fleet News running costs database, February 2011

Choosing a supplier

Finding the perfect leasing partner can be a difficult challenge that poses many questions.

Companies are committing to a long-term relationship and often it is difficult to tell exactly how it will work before taking the plunge.

To ensure there are as few surprises as possible, it pays to do a little research into your prospective supplier.

A tough approach needs to be taken. With hundreds of contract hire and leasing providers all battling for the same fleet business, they should all be prepared to be highly competitive to win your contract.

Operators need to consider a number of factors when deciding who will be the best provider for the business.

Sales executives often appear to promise the earth at the proposal stage, so ask them to prove their claims with examples from customers who also receive the same services.

Make a checklist of services offered by a range of suppliers, as it may be the smaller ones who provide the products that best meet your needs.

Check if there is a dedicated account manager available who will understand your business on a personal level, and ensure there is also a colleague who will be able to cover during holidays and sickness.

Ask if the company has a service level agreement that is measured and regularly reviewed, and look carefully at their external quality accreditations.

Is the provider flexible enough to tailor products to your fleet's needs?

Check if the leasing company is a member of the British Vehicle Rental and Leasing Association (BVRLA), which sets high quality standards for its members.

A list of the top 20 UK leasing companies by vehicle fleet size, taken from the 2010 FN50 report published by Fleet News, is shown right.

Position	Company	Vehicles
1	Lex Autolease	307,133
2	Leaseplan	123,882
3	Lombard Vehicle Management	81,800
4	Arval	80,753
5	ALD Automotive	56,502
6	Daimler Fleet Management	50,264
7	Volkswagen Group Leasing	47,700
8	ING Car Lease	47,615
9	Alphabet	47,176
10	GE Capital	45,704
11	Arnold Clark Finance	41,987
12	Masterlease	33,532
13	BT Fleet	31,692
14	Hitachi Capital Vehicle Solutions	30,734
15	Inchcape Fleet Solutions	23,135
16	Citroen Contract Motoring	22,162
17	Peugeot Contract Hire	20,067
18	Zenith Provecta	19,990
19	Leasedrive Velo Group	15,200
20	Toomey Leasing Group	14,561

Source: Fleet News FN50, November 2010

BVRLA
www.bvrla.co.uk

The British Vehicle Rental and Leasing Association is the trade body for the vehicle rental and leasing industry in the UK, which regulates the majority of the industry through a code of conduct and regular inspections.

Funding options compared

Although contract hire is one of the most popular forms of funding, there are plenty of other options available: it takes time and careful thought to choose the right one for your needs. Choose wisely and you can make your company's money go further, whereas cutting corners could see your costs soar. Here we look at the pros and cons of funding options that are currently available.

Scheme	Vehicle owned by	On or off fleet's balance sheet	RVs risk to fleet?	Mileage/wear imitations?	Advantages	Disadvantages
Outright purchase	Fleet	On	Yes	No	‣ Flexibility: fleet retains full control of fleet and is not locked into contracts ‣ Any resale profits (if applicable) at the end of the vehicle's life will be retained by the fleet ‣ Capital allowances available for depreciation element ‣ VAT on maintenance and repairs can be reclaimed	‣ Fleet unable to reclaim full 17.5% VAT on purchase price unless it is used solely for business ‣ Full exposure to residual value risk ‣ Administration burden lies with the fleet ‣ Fleet takes risk for unexpected repair costs ‣ Ties up capital that could be used elsewhere
Contract hire	Funding company	Off	No	Yes	‣ Little to no risk for the company as full residual risk is passed to the leasing company ‣ Low initial outlay – typically three rentals in advance ‣ Fixed outgoings make reliable budgeting easy ‣ Tax-efficient for cars up to c£23,000 ‣ Administration burden handed to third party	‣ Early termination and excess mileage charges give perceived inflexibility with fixed term contract ‣ Unsuitable for fleets with unpredictable mileage ‣ Fleet does not own vehicle so cannot benefit from potential residual value rewards ‣ Full VAT liability for non-VAT-registered companies
Finance lease	Funding company	On	Yes	No	‣ More transparent and flexible than contract hire ‣ Payment patterns can be structured to suit business ‣ Incorporates a balloon payment reducing monthly costs ‣ Provides additional credit line ‣ VAT can be reclaimed by fleet on finance element, subject to 50% restriction where private use occurs	‣ Fleet exposed to risks of ownership ‣ Fleet liable for unexpected maintenance, repair and potential residual value losses ‣ Limited tax allowances on vehicles over £12,000 ‣ Sale proceeds may not match final balloon ‣ Full VAT liability for non-VAT-registered companies
Hire purchase	Fleet	On	Yes	No	‣ Any profit at disposal retained by fleet ‣ Interest element of repayments is offset against tax up to £12,000 ‣ Opens new credit line ‣ Fleet claims writing down allowances, though limited to 25% – less for cars costing over £12,000	‣ Potentially, a large deposit is required ‣ Administrative burden retained by company ‣ Company is liable for RV risk as disposal is transferred to the company ‣ Vehicles are on-balance sheet which may inhibit further borrowing
Contract purchase	Fleet	On	No	No	‣ Combines tax advantages of out- right purchase with cashflow and operation benefits of contract hire ‣ Tax-efficient for vehicles over £23,000 ‣ No residual value risk ‣ Fleet can claim capital allowances ‣ Efficient for non-VAT companies as irrecoverable VAT is spread over the contract term	‣ Fleets can reclaim VAT on the vehicle capital cost only if it is used solely for business mileage ‣ Vehicles appear on-balance sheet and count as assets which may or may not be advantageous ‣ Contracts include mileage and wear limitations
Employee car ownership scheme (ECOS)	Driver	Off	No	Yes	‣ Potential tax and National Insurance Contributions savings for drivers and the company if operated properly on both ‣ Choice of vehicle not limited by BIK taxation ‣ More cost-effective than cash lump sum	‣ Can be costly and risky to launch ‣ Driver mileage returns vital. Cost of driver support can be much higher than expected ‣ HM Revenue and Customs take a keen interest in ensuring schemes are compliant