EXPLANATORY MEMORANDUM TO

THE CAPITAL ALLOWANCES ACT 2001 (CAR EMISSIONS) (EXTENSION OF FIRST-YEAR ALLOWANCES) (AMENDMENT) ORDER 2021

2021 No. 120

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 Tax relief is available to businesses for their capital investment in equipment through capital allowances. These include a type of capital allowance known as a first year allowance (also known as an enhanced capital allowance – ECA) for certain types of capital investment. There is a separate 100% ECA for investment in cars with low CO_2 emissions, zero-emission goods vehicles and equipment for gas refuelling stations for vehicles. These three ECAs are set to end in April 2021. The levels of capital allowances available to businesses for purchasing cars or the tax relief for hiring such cars, are also determined by the level of their CO_2 emissions. New cars purchased with emissions up to 50 grams per kilometre driven (g/km) are eligible for the ECA. Cars purchased with emissions up to 110g/km (and where the ECA has not been claimed) are eligible for another type of capital allowance known as a writing down allowance (WDA) at 18% or where hired, a 100% deduction for their hire costs. Cars purchased with emissions levels above 110g/km are eligible for a WDA at 6% or where hired, an 85% deduction for their hire costs. This order extends the availability of these three ECAs until March/April 2025. It reduces the CO_2 emission threshold for the ECA for cars with low CO_2 emissions to 0g/km from 1 April 2021 and that for the WDA to 50g/km from 1 April 2021 (for corporation tax) and 6 April 2021 (for income tax). It also maintains the previous 110g/km threshold for those cars hired through leases entered into before that date.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

"In my view the provisions of the Capital Allowances Act 2001 (Car Emissions) (Extension of First-year Allowances) (Amendment) Order 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 Section 45D of the Capital Allowances Act 2001 contains the provisions relating to the ECA scheme for low CO_2 emission cars. Section 45D(1)(a) provides that the scheme ends on 31 March 2021. Section 45D(4) provides that cars must emit CO_2 of 50g/km or less to qualify. This order extends the scheme for a further four years to 31 March 2025. It also amends the qualifying CO_2 threshold to 0g/km.

6.2 Section 45DA of the Capital Allowances Act 2001 contains the provisions relating to the ECA scheme for zero-emission goods vehicles. Section 45DA(1)(a) sets the period in which the relevant first-year expenditure must be incurred. This scheme ends on 31 March 2021 for corporation tax and 5 April 2021 for income tax. This order extends the scheme for a further four years, to 31 March 2025 for corporation tax and 5 April 2025 for income tax.

6.3 Section 45E of the Capital Allowances Act 2001 contains the provisions relating to the ECA scheme for gas refuelling equipment. Section 45E(1)(a) provides that the scheme ends on 31 March 2021. This order extends the period by four years to 31 March 2025.

6.4 Section 104AA of the Capital Allowances Act 2001 contains the provisions relating to the WDA. Section 104AA(4) provides that the applicable CO_2 emissions figure in relation to cars must not exceed 110g/km. This order amends the qualifying CO_2 emission threshold to 50g/km.

6.5 Section 48 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) and section 56 of the Corporation Tax Act 2009 (CTA 2009) deal with the restriction of the tax relief available in calculating trading profits for car hire costs for certain cars, including cars which do not have low CO_2 emissions. Section 49(1A) of ITTOIA 2005 and section 57(1A) of CTA 2009 define "a car that has low CO_2 emissions" for the purposes of the restriction by reference to the same definition in section 104AA of the Capital Allowances Act 2001. This order includes a saving provision, so that to determine whether the restriction applies for expenses incurred on the hiring of a car for a period of hire beginning, and under a contract entered into, before 1 April 2021 (for corporation tax) or 6 April 2021 (for income tax), the definition of "a car that has low CO_2 emissions" shall be read as if the changes to section 104AA(4) have not been made.

7. Policy background

What is being done and why?

7.1 Capital allowances enable businesses to claim tax relief through writing down the costs of qualifying capital expenditure on equipment against their taxable income. The Annual Investment Allowance (AIA) is another type of 100% capital allowance available for investment in most equipment (the main exclusion being cars) up to an annual cap of £1 million until 31 December 2021 and thereafter, £200,000. Where 100% ECAs or the AIA are available, such expenditure can be entirely written down against taxable income for the tax period in which the expenditure is incurred. Otherwise, WDAs are then available for that tax period and succeeding tax periods on a reducing balance basis at rates of 18% (the main rate) or 6% (the special rate) depending on the type of expenditure. WDAs effectively spread the relief over multiple tax periods until the expenditure has been entirely written down. ECAs (and AIA) therefore provide tax relief which has a timing and as such a cashflow benefit, over WDAs.

7.2 The United Kingdom (UK) is committed to reducing its greenhouse gas emissions to net zero by 2050. Carbon dioxide is one of the key greenhouse gases which contribute to global warming and tailpipe emissions from UK road vehicles is estimated to represent a significant part of the UK's contributions to this. The ECAs for cars with low CO_2 emissions, zero-emission goods vehicles and equipment for gas refuelling stations encourage businesses to buy cleaner vehicles through the cashflow benefit which they provide.

7.3 The WDAs available from April 2009 for the purchase of cars are determined from the level of their CO_2 emissions which is ascertained by whether the car has CO_2 emissions up to a current threshold of 110g/km or whether it is electrically propelled. A flat rate disallowance (currently 15%) was also introduced from April 2009 for rental costs incurred by businesses hiring a car for more than 45 days in certain circumstances and which has emissions exceeding a certain threshold. That threshold is determined from that set for capital allowance WDAs (110g/km) and such business users entering into leases hiring cars with emissions above that threshold, will only be eligible to claim 85% of the hire costs against their business income. The 15% disallowance of hire costs eligible as a tax deduction for businesses is known as a lease rental restriction (LRR).

7.4 In early 2020, the government announced its intention to bring forward the phasing out of the sale of new petrol, diesel and hybrid cars and vans from 2040 to 2035 or earlier. After the consultation concluded, the government confirmed that the sale of new petrol and diesel cars and vans will be phased out from 2030, with all new cars and vans to have zero tailpipe emissions by 2035. In line with the wider policy to incentivise the move to zero CO_2 emitting cars and vans within the UK, this order ensures that these ECAs remain available to provide such an incentive until 2025 when they were otherwise set to end in 2021. In respect of the purchase and hire of cars, it also reduces the capital allowance CO_2 emission thresholds in respect of the ECA from 50g/km to 0g/km, and for the WDAs which also determine the LRR, from 110g/km to 50g/km. In respect of the LRR, the order also ensures that its reduction only applies to leases entered into on or after 1 April 2021 (for corporation tax) and 6 April 2021 (for income tax), and so avoids a disruption to those businesses committed to existing leases, which would otherwise see an unexpected increase in their tax liability before the lease term has expired.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 This order does not amend another instrument and there is no need for consolidation.

10. Consultation outcome

10.1 No consultation took place as this instrument will ensure that these existing ECAs remain available until 2025 and the reduction in the CO_2 thresholds for cars should encourage businesses to purchase or hire cars with lower such emissions, which accords with the wider policy to reduce the UK's greenhouse gas emissions to net zero by 2050.

11. Guidance

11.1 HM Revenue and Customs will update the guidance on the website Gov.uk in respect of the revised CO_2 emission thresholds to apply from 1 April 2021 (https://www.gov.uk/capital-allowances/business-cars).

12. Impact

12.1 The impact on business, charities or voluntary bodies is expected to be negligible as the order extends the availability of existing ECAs and the reduction in the CO_2 emission thresholds will only affect capital allowances for business cars purchased from April 2021. Where business cars are hired and the LRR could apply (which uses the threshold for WDAs), the order will affect only those leases entered into on or after 1 April 2021 (for corporation tax) and 6 April 2021 (for income tax). The reduction in the threshold for WDAs could mean that the LRR will apply to more business cars which are hired.

12.2 There is no, or no significant, impact on the public sector.

12.3 A Tax Information and Impact Note covering this instrument was published on 11 March 2020 alongside the Budget Report 2020 and is available on the website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. It remains an accurate summary of the impacts that apply to this instrument.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

13.3 The basis for the final decision on what action to take to assist small businesses is affected by the nature of the changes being made. The underlying policy intent of the changes being made is to encourage investment in less polluting vehicles by extending the availability of existing ECAs and reducing CO_2 emission thresholds for capital allowances. No mitigating action is proposed to minimise regulatory burdens on small businesses because the measure will only affect purchases of vehicles and equipment, or leases for the hire of cars, made from April 2021, and the measure supports the government's wider policy to reduce the UK's greenhouse gas emissions to net zero by 2050.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is through communication with affected taxpayer groups.

14.2 The regulation does not include a statutory review clause. None is required under Section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 because the power by which this instrument is made is being exercised so as to make or amend provisions imposing, abolishing or varying any tax duty, levy or other charge or provisions in connection with such provisions.

15. Contact

15.1 John Rodgers at HM Revenue and Customs Telephone: 03000 514188 or email: john.p.rodgers@hmrc.gov.uk can be contacted with any queries regarding the instrument.

15.2 Mike Crabtree, Deputy Director for CT Innovation and Growth, at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.