

# Press Release

## ECO savings too good to be true?

Since they emerged in the early 1990's, Employee Car Ownership (ECO) schemes have enjoyed considerable acclaim on the basis of their ability to substantially reduce fleet provision costs without eroding the benefit proposition to eligible employees. This phenomenon has been endorsed by some of the UK's largest employers embracing this particular arrangement as their chosen preference for delivering vehicle requirements in the workplace.

In the second of a series of articles, Gerry O'Neill, Commercial Director of ECO specialists Car Benefit Solutions (CBS) examines how these savings are realised and what potential challenges employers should consider when examining the economic case for implementing this increasingly popular benefit methodology.

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The prospect of reducing fleet costs in a challenging economic environment is one of universal appeal. Historically, this phenomenon has been well articulated in the sales arena by many providers of ECO offerings. In my opinion, few decision makers will dismiss the prospect of a substantial saving without at least satisfying themselves as to how this could be possible. However, if the promise of a silk purse is not to metamorphosise over time into a sows ear, it is critical that the corporate in question not only grasps the headline figures but also their composition, validity and key associated sensitivities if the decision to proceed is to be justified over time.

In order to properly examine the savings debate, it is worthwhile illustrating how typical fleet costs are derived. Assuming the starting point is the current most popular option of company car provision through a traditional leasing arrangement and excluding the soft costs (typically resource orientated) relating to fleet operation, the following items are the primary expense components:

Vehicle Related    Private Fuel (optional)

- Vehicle instalments (Finance)    Private Fuel Costs
- Vehicle instalments (Maintenance)    Employers Class 1A N.I.
- Disallowable VAT    VAT Scale Charge Returns
- Employers Class 1A N.I.
- Motor Insurance Premiums
- Business Fuel Costs
- Opportunity Cost of Funds
- Corporation Tax Restrictions

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The concept of ECO is well documented - company cars are replaced with cash allowances, the maximum proportion of which are delivered using the 'free-of-tax' shelter afforded by the Inland Revenue Approved Mileage Allowance Payments (AMAP) for business mileage in a private vehicle. This applies by virtue of the fact that participating employees enter into a personal finance agreement that ensures title in the vehicle passes to them on delivery thereby successfully navigating the legislative definition of a company car.

In making the change, the tax saving the employee subsequently enjoys is redirected as a contribution against the operating cost for a typical vehicle for their entitlement level. Ultimately, should they wish to select an alternative vehicle (whether more or less expensive) their contribution is normally flexed with reference to the differential whole life cost between the selected car and the nominated benchmark.

Examining the financial consequence of this change for the employer shows a very different set of costs indeed, typically represented as follows:

Vehicle Related    Private Fuel (optional)

Cash allowance (free of tax under AMAP)    Fuel costs not funded by employee  
 Cash allowance (engrossed for tax and NI)    Tax engrossment on above  
 Business fuel costs  
 Opportunity cost of funds

Simply put, the economic impact to an employer is represented by the difference between these two sets of costs when applied across the entire fleet.

The key differentiator with an ECO arrangement is that the focal point for the employer moves away from vehicle repayments and towards the quantum of cash allowance that will keep employees whole with reference of their ability to afford typical/benchmark vehicles when recognising the tax saving they realise as a result of the architectural change. In many cases, especially (but not exclusively) with restricted supply conditions, the amount of allowance required can be surprisingly low, giving rise to savings estimates guaranteed to grab the attention of any conscientious Finance Director.

It is at this juncture that I would encourage extreme caution by interested parties.

It is my opinion that these schemes work best when sponsored by the employer to absolutely replicate the 'look and feel' of company cars for the eligible employee population. To do so can often give rise to secondary taxation costs arising from the settlement of Early Termination penalties and Excess Mileage charges on the employee's behalf. Employers with high concentrations of 40% tax payers need to be particularly vigilant in this regard as the secondary tax consequence of making such a payment will increase the actual cost by some 87%. Providers that fail to highlight this fact may well be partially communicating the overall position.

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Furthermore, potential suppliers who position savings attributable to Private Fuel provision on fully expensed fleets as part of the business case for change could again be misleading the uninformed employer. Through a process of driver awareness training on the creeping tax liabilities and subsequent thresholds of private mileage required for this benefit to be viable to the individual, it may be possible to realise the vast proportion of any saving from Private Fuel provision without necessarily adopting an ECO scheme.

ECO simply facilitates this process by eliminating Class IA Scale Charge contributions and VAT Scale Charge returns. Employees wishing to retain access to Private Fuel post transition simply contribute their tax saving to their employer and continue to draw unlimited fuel for personal motoring. This in effect is akin to 'self funding' the fuel used for private purposes up to the value of their previous tax liability. The cost of fuel drawn in excess of this contribution (together with the resultant tax consequence) is normally borne by the employer. Only in extreme circumstances will this fail to reduce costs.

In concluding, my advice to employers trying to navigate this subject matter can be succinctly summarised thus:

1. Research your fleet demographics. Don't supply 'broad brush' assumptions and expect any degree of accuracy in the result.
2. Take the time to prepare properly by calculating your current costs ahead of any discussion meeting. It's surprising how few companies actually do.
3. Ensure a broad selection of illustrative examples are used and not just a couple of hand-picked vehicles.
4. Insist that all cost and savings estimates presented by the supplier are annualised and pre-taxation.
5. Dismiss savings that focus on the employee's position. That is within your gift in setting future policy.
6. Ignore future costs that will not be incurred should you decide to introduce an ECO scheme. They are of no consequence once you decide to change.
7. Get behind the numbers and challenge sensitivities with scenario exploration.
8. Divorce vehicle and Private Fuel savings for the reasons stated above.
9. Ensure the costs of sponsorship are quantified in respect of Early Termination and Excess Mileage charges.
10. Ask if the saving can be underwritten and what set-up costs are involved.

Finally, once you have satisfied yourself that the estimate is both robust and achievable, give due consideration for budgeting purposes to the fact that (assuming you have not Outright Purchased your fleet), it will take you a full rotation of the current vehicles to realise the estimated economies.

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