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**Report on the interaction between  
company cars, employee car ownership  
scheme cars and mileage allowance  
payments**

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## Chapter 1

### Introduction

This report sets out the findings of the HM Revenue & Customs review of the taxation of Employee Car Ownership schemes (ECOS) announced by the Government at Budget 2006, and the interaction between ECOS, company car tax (CCT) and tax-free mileage allowance payments (AMAPs).

The aims of this review were to obtain evidence about:

- how ECOS work (including financial arrangements);
- factors that have contributed to the expansion of these schemes;
- the impact ECOS have had on emissions;
- whether ECOS offer an advantage to employees or employers that should be taxed (and subject to NICs) as a benefit-in-kind and if so how; and
- the wider impact that such a charge might have, for example on ECOS themselves or on the used car market.

### 1.1 Background

In April 2002, as part of Government's strategy to reduce greenhouse gas emissions and address climate change and environmental protection, it introduced a comprehensive reform of CCT linking the calculation of the charge to levels of carbon dioxide emissions of the car.

In March 2006, HMRC published its second stage evaluation report of the reform<sup>1</sup>, which built on the findings from the first stage evaluation report published in April 2004. The findings showed that the CCT reform had led to a significant reduction in CO<sub>2</sub> emission levels from company cars, but as a consequence of the reform, there had also been a drop in revenue from CCT in terms of both income tax and National Insurance Contributions (NIC), for the Exchequer.

The evaluation suggested that there were two key reasons for this. First, the success in encouraging company car owners to drive cars with lower CO<sub>2</sub> emissions means that levels of tax and NICs will fall as a result. Second, the evaluation work showed that there has been a reduction of 400,000 company cars, from around 1.6 million in 1999, to 1.2 million in 2005. Survey results suggested that contributing to this drop in company car numbers are around 150,000 employees currently involved in Employee Car Ownership Schemes (ECOS).

As a result of the CCT evaluations findings, on 22 March 2006 as part of its Budget Report<sup>2</sup>, the Government announced a review of ECOS, stating:

*"...In light of the findings from the company car tax evaluation that show a rise in the number of employee car ownership schemes (ECOS), HM Revenue and Customs will review the taxation of ECOS and benefits employees derive from them, with a view to possible changes."*

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<sup>1</sup> <http://www.hmrc.gov.uk/budget2006/company-car-evaluation.pdf>

<sup>2</sup> Chapter 7 - Paragraph 7.79

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Further announcements on the progress of the review were announced at Pre-Budget Report 2006<sup>3</sup>

*“... HMRC have undertaken extensive discussions with business which have indicated that: there are a number of different ECOS schemes, some of which have been designed to provide an ongoing benefit to employees that is currently not taxed or subject to NICs; and that the carbon emissions of an average ECOS car are around 20g per kilometre higher than an average company car. Furthermore, there is a noticeable interaction between the tax treatment of ECOS, tax-free mileage allowances and rates of company car tax, which may have contributed to the popularity of ECOS. HMRC will hold further discussions with industry in early 2007...”*

and in Budget 2007<sup>4</sup>

*“...HMRC has undertaken extensive discussions with business during summer 2006 and January 2007, which demonstrated there are a number of different ECOS schemes, and that there is a noticeable interaction between the tax treatment of ECOS, tax-free mileage allowances (AMAPs) and rates of company car tax, which may have contributed to the popularity of ECOS. Furthermore, the review has suggested that the more structured ECOS schemes make extensive use of AMAPs to reduce their tax and NIC liabilities, which may provide a potential incentive to drive a greater number of business miles. Therefore, ahead of the Pre-Budget Report, the Government will consider the case for changing the structure of AMAPs to align the tax/NICs treatment and to ensure that rates and thresholds are set at an appropriate level to promote environmentally friendly business travel.”*

Copies of the letters inviting contributions can be found at Appendix A.

## **1.2 Process of the Review**

During the ECOS review, HMRC spoke to a wide range of businesses and organisations, including public sector bodies and trade representatives, details of which can be found at Appendix B. The discussions were held in June 2006 and January 2007 and written contributions were invited on AMAPs in early Summer 2007. The diversity of the participants has enabled all aims of the review to be discussed, and a wide range of opinions to be represented.

HMRC considers that the evidence gathered from face to face meetings, and from responses to specific questions published at the same time as the open invitations, offers a good indication of the views of a wide range of businesses. However, as the information was provided on a voluntary basis, the report's findings are not necessarily representative of all businesses. This report summarises HMRC's findings as a result of these discussions.

## **1.3 Summary of findings**

It was clear from discussions with industry that there are a number of different types of ECOS, with differing levels of employer involvement. Many businesses need their employees to travel on business by car and need the flexibility to decide how the car is provided to best meet business and financial needs. This remains critical to the economy. However to some extent, business behaviour is also driven by the differing

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<sup>3</sup> Chapter 7 – paragraph 7.71

<sup>4</sup> Chapter 7 – paragraph 7.80

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tax treatments and administrative burdens associated with company cars and private cars.

It is estimated that there are currently around 100,000-150,000 cars in ECOS. The review has demonstrated that there is interaction between ECOS, AMAPS and rates of CCT, which may have contributed to the popularity of ECOS. In particular:

- ECOS are, in many cases, perceived as a tax and NICs efficient alternative to company cars - especially for higher rate tax payers undertaking high business mileage in the most polluting cars;
- the more structured ECOS can make use of AMAPs to reduce employee and employer tax and NICs liabilities and this may provide a potential incentive to drive a greater number of business miles; and
- although CCT is perceived by many employers to be burdensome to administer, the review has indicated that the administration costs of running a structured ECOS in accordance with all the relevant legislation are also quite high. However, some employers are prepared to meet these costs because of the tax and NICs savings associated with ECOS and not having to comply with the reporting procedures associated with company cars.

In light of these findings, it was decided at Pre-Budget Report 2007 that the factors in favour of imposing a new tax specifically on ECOS were currently outweighed by those against. However, the Government will continue to monitor growth in this sector and how it impacts on other aspects of the taxation of business cars.

As tax-free mileage allowance payments are a factor in the development of ECOS, as part of this review HMRC also considered potential changes to the structure of this scheme. It was concluded, however, that the administrative and simplification benefits of the current structure outweighed the benefits of reform at this time.

## Chapter 2

### Use of cars in business

The need for employees to travel by car for business purposes can be facilitated by their employer in a number of ways. These choices can be grouped into four main categories:

- company car schemes;
- cash allowances;
- ECOS; and
- reimbursement of business motoring expenses based on mileage rates where the employee uses his own car for business travel.

Figure 1 provides a diagrammatic view of the various options available to employers and how these options can be perceived. There are other options available to employers including pool and hire cars which are not discussed in detail in this report.

All of these options are available for employers to use in different circumstances. In some cases an employer will adopt more than one approach, such as running both a company car scheme and an ECOS scheme, with entitlement for the employee based on status, or the type and amount of business use.

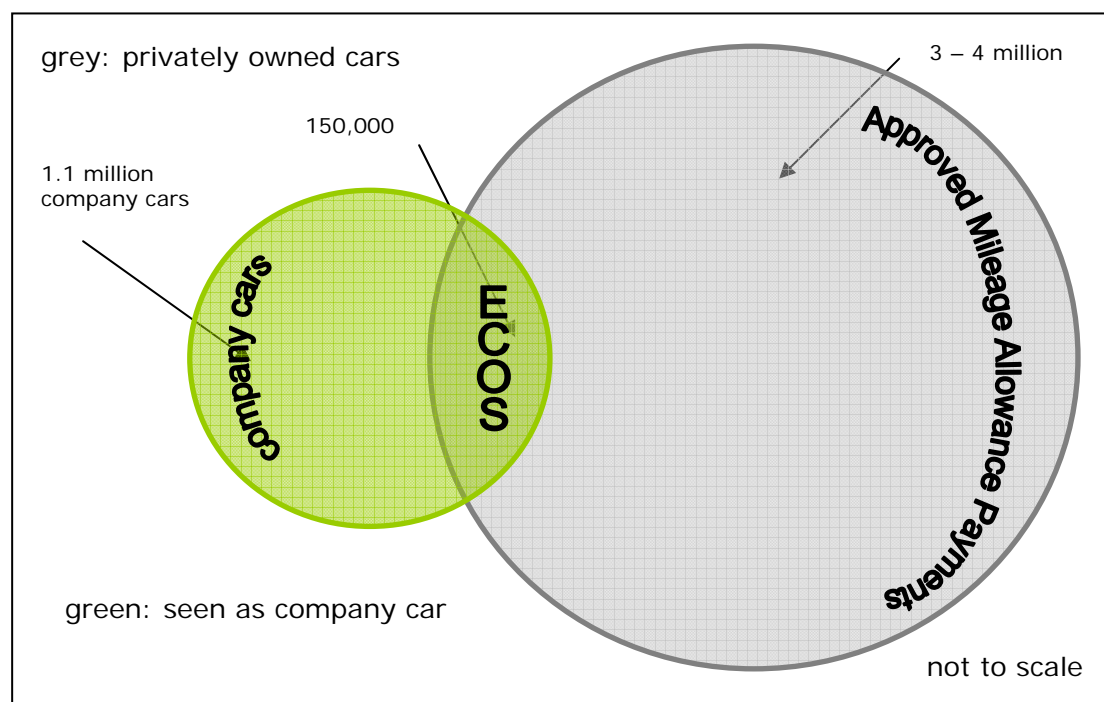


Figure 1 – Illustration of the various options available to employers and how they are perceived

### 2.1 Company cars

If an employer buys or leases a car which is then made available to an employee for private use, a benefit-in-kind arises on the provision; ownership of the vehicle remains with the employer or leasing company. This arrangement is known as a company car. The employee pays income tax and the employer is liable to Class 1A National Insurance Contributions (NIC) on this provision.

CCT was reformed in April 2002 and is now based on carbon dioxide emissions to encourage employers and employees to choose less polluting cars (see Appendix C for

more details of how company cars are taxed). These changes have been forecast to deliver significant carbon savings of between 0.4 and 0.9 million tonnes of carbon per year by 2020.

Traditionally, company car schemes have been seen as having a positive influence on recruitment and retention of staff and other HR issues. However, in recent years the popularity of the company car has decreased as employers review their fleet policies with a view to reducing overall business costs. The 2006 HMRC second stage evaluation report of the CCT reforms showed that the number of company cars has fallen from 1.6 million in 1999 to approximately 1.1 million at present. Company cars are no longer seen as the main option for employers to meet their business transport needs, as other alternatives are available – such as ECOS and cash allowances.

## 2.2 Privately-owned cars

There are currently several million (up to 4 million) private cars used by employees, in both the private and public sectors, for business mileage each year. The private car fleet can be seen as a spectrum with the effects of the various factors and forces operating differently depending on the degree of business and private use.

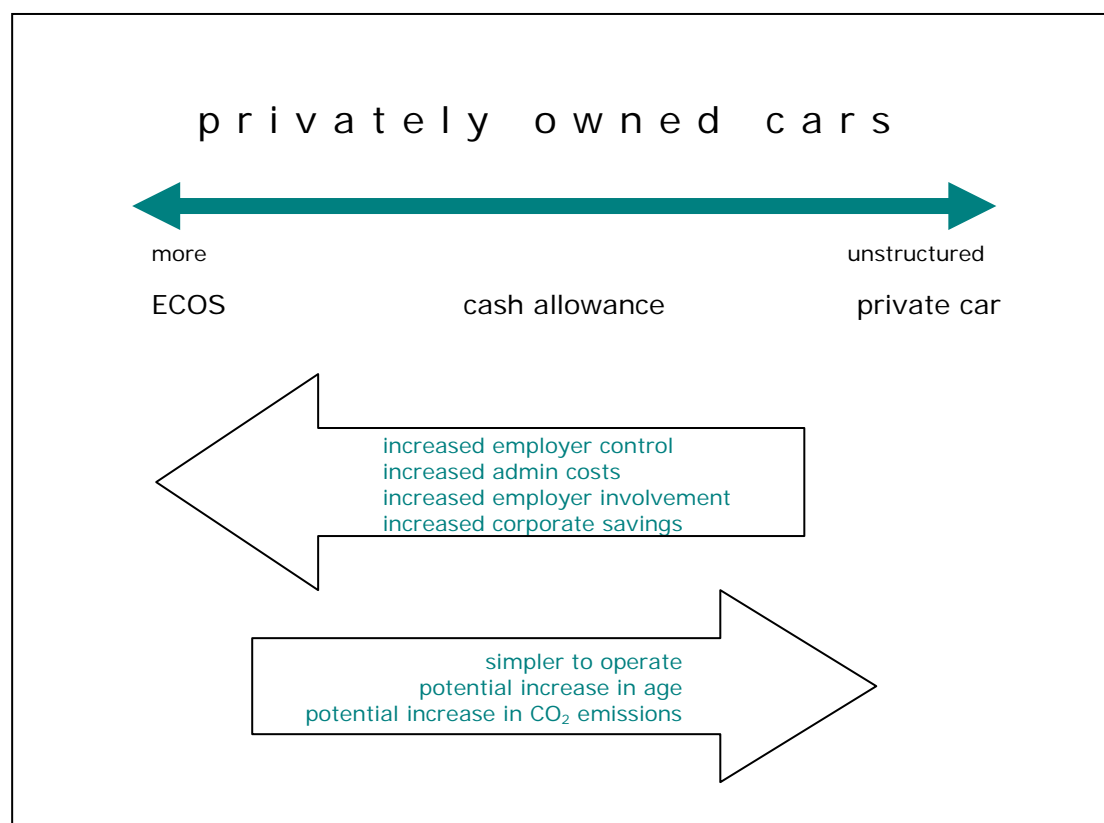


Figure 2

2 - range of privately-owned cars used for business mileage

At one end of the spectrum are cars which have been sourced through more structured ECOS where there is employer involvement throughout the term of the car purchase by the employee. There are around 100,000 – 150,000 ECOS cars of which about two-thirds are more structured schemes. At the other end there are privately purchased cars where the employer has had no involvement, see Figure 2.

### 2.2.1 Cash allowances

Employers may offer employees cash allowances as part of a flexible remuneration package in place of a company car. There are no figures available on the number of

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employees who are given cash alternatives because they are treated in the same way as cash salary and subject to income tax and National Insurance under the PAYE system. This is a common reason for employers to choose this option because there are no additional administration burdens or costs associated with managing the fleet and maintaining records.

Employers may offer employees a choice of cash allowance or company car. Employees will choose a cash allowance for a variety of reasons;

- they may already have a car;
- the need and ability to make journeys by car is limited by external factors such as the availability of public transport, congestion, parking or congestion charge or
- employees may simply need the additional cash.

Some employers, especially those that are part of multi-national groups have chosen to no longer offer employees a company car and in this case the cash allowance effectively becomes compensation for the loss of a right to a company car.

If an employer provides a cash allowance it can be provided with restrictions or conditions on the type of vehicle that can be used for business by the employee but this is not common and most employees who receive a cash allowance can spend it in any way they wish. The amount however is usually an agreed amount and is generally non-pensionable.

### 2.2.2 Employee Car Ownership Schemes (ECOS)

The second evaluation of the 2002 CCT reforms indicated that where employees opt out of company cars they may be offered alternative forms of remuneration, for example cash allowances or a car through an ECOS.

ECOS is a term that covers a wide variety of different arrangements, some of which have been around since the early 1990s. It is clear from discussions with industry that there are a number of different types of scheme that could be within this description. It can include:

**manufacturer schemes**, where employees are encouraged to purchase a vehicle, or vehicles, from the company. Employees are able to purchase the manufacturer's marques at a discount, sometimes only retaining them for a matter of weeks or months before selling them back to the manufacturer. These vehicles are an important source of low mileage second hand vehicles and also ensure that employees are seen to be driving the manufacturer's marque.

**affinity schemes**, where the employer takes no active role beyond facilitating the purchase of the car. All transactions and arrangements are between the employee and the car provider. No additional income tax or NICs are due in this type of arrangement.

**structured schemes** where the car is owned by the employee, but there is a degree of employer involvement in the provision of the car.

### 2.3 Tax Free Mileage Allowances for private cars used for business purposes

Approved Mileage Allowance Payments (AMAPs) were introduced in April 2002. They provide exemption from tax and NICs up to a fixed amount if the employer reimburses the employee for business miles travelled in the employee's own car. The aim was to:

- keep the Exchequer cost under the new scheme broadly the same as under the old the Fixed Profit Car Scheme (FPCS); and
- give tax relief for amounts which represent a fair recompense for car use but not a profit, and
- make it easier to administer for employers and HMRC, compared with the FPCS; and
- encourage the use of more efficient cars and, reduce CO<sub>2</sub> emissions by making the tax and NICs-free allowance the same regardless of the size of car.

AMAPs are designed to broadly cover costs such as fuel, additional business insurance, maintenance, tyres, depreciation and other incidental costs relating to business mileage only. The majority of AMAP users drive less than 5,000 business miles per year so their choice of car is often for lifestyle reasons and not solely business related. The current rates and thresholds for AMAPs are:

1 – 10,000 miles	40p per mile
10,000 + miles	25p per mile

No primary (employee) or secondary (employer) Class 1 National Insurance contributions are due, regardless of the number of business miles travelled, if the employer pays up to the approved mileage allowance rate of 40p. This mismatch between the tax and NICs treatment of AMAPs, (there is no 10,000 miles threshold for NICs), is reflected in the design of some structured ECOS and the move from company cars to cash allowances.

If the employer reimburses less than the fixed amount, the employee is entitled to tax relief on the difference. There is no equivalent NICs relief. Employers can, of course, pay whatever amount they wish but any amount above the exempt amount is chargeable to tax and NIC. If employers reimburse up to the set amount, as many do, there is no obligation to report details of the mileage payments to HMRC. It is estimated that there are between 3 and 4 million employees that use AMAPs each year, around half of which are in the public sector.<sup>5</sup>

Table 1 – showing the mileage and approximate percentage of AMAP drivers<sup>6</sup>

Employee's Total Annual Business Mileage	Estimated Number of Drivers Claiming AMAPs	Proportion of Total
1 – 4,999 miles	2.9m	70%
5,000 – 6,999 miles	0.4m	11%
7,000 – 9,999 miles	0.3m	7%
10000 miles and over	0.4m	12%

At the time of the review, some AMAPs users who travel relatively few miles a day in fairly new cars covering a local area argued that the rates were insufficient as they did not cover the depreciation. Other drivers, who used older cars on an irregular basis however, perceived the rates to be quite generous. The National Travel Survey indicates that the majority of business car drivers drive less than 5,000 business miles so the

<sup>5</sup> As AMAPs are tax and NICs free up to a set amount, employers are not required to provide information to HMRC about the business mileage being carried out by their employees. As a result these estimates are based on limited data.

<sup>6</sup> Based on limited information obtained since the introduction of AMAPs in 2002.

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more generous threshold (the threshold under the old FPCS was 4,000 miles) is not important to them.

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## Chapter 3

### How ECOS work

#### 3.1 Different ECOS Structures

There are several common elements in structured ECOS, some or all of which might be used in any one scheme. These are:

- use of Approved Mileage Allowance Payments (AMAPs);
- bulk-buying negotiated discounts;
- interest free or cheap loans;
- cash allowances;
- guaranteed buy back with guaranteed residual values; and
- maintenance, insurance and servicing costs included.

The role of the employer in each scheme can vary from that of a simple introducer to controlling the calculation and delivery of payments on the employee's loan on the car. To distinguish the different levels of employer involvement, the report refers to schemes where the employer has little or no ongoing involvement in operating the scheme as "less structured ECOS". Where the scheme requires moderate or substantial ongoing employer involvement, these are referred to as "more structured ECOS".

In the remainder of this report we have used the term "employee car ownership scheme" for cars that are **not** in either manufacturer schemes or affinity schemes

##### 3.1.1 Less structured ECOS

In this type of scheme there is little employer involvement once the scheme has been established. The employee is paid a fixed monthly amount. This is often made up of a variable tax and NICs-free amount calculated by reference to the number of business miles travelled by the employee in the month, and a taxable and NICable cash amount. The greater the business mileage driven during the month, the smaller the cash allowance is and the less tax and NICs the employee and employer pay. However, once all the arrangements are in place the employee is responsible for all payments under the loan agreement: the employer has no further involvement.

##### 3.1.2 More structured ECOS

These schemes rely upon a greater level of participation by the employer, working with the car provider and the employee. The finance provider usually calculates the payments, the employer is then responsible for ensuring that the payments are made on time and the correct amount is paid. The employee often has no day-to-day involvement in the process. The employee's purchase of the car may also involve an interest free loan<sup>7</sup> and be organised to ensure that entitlement to AMAPs and the associated NICs advantages is maximised<sup>8</sup>.

The employer involvement in managing this type of ECOS is crucial to their success without which these schemes would not be viable. This involvement minimises the risk to the car and loan provider and is such that the employer is responsible for all of the scheme's payments, notwithstanding that in law they are the responsibility of the employee to whom the car belongs (and who has signed the loan agreement). In this type of arrangement the employee's perception often is that the vehicle is to all intents

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<sup>7</sup> Interest free loans are capped at a maximum £5,000.

<sup>8</sup> In some schemes the way in which AMAPs are calculated or averaged across employees is incorrect in law and HMRC is addressing this as part of its compliance activities.

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and purposes a company car but without the associated tax charge; the data supplied in the course of the review suggests that most employees return the car at the end of the loan period, just as they would a company car.

Because ECOS cars are privately owned, HMRC does not hold any tax data that might allow us to estimate the size of the market. Therefore, we have only tentative estimates based on what has been provided to us by employers and fleet operators. The analysis carried out on the responses received as part of the CCT evaluation estimated that there are currently around 100,000 – 150,000 ECOS cars. Estimates provided by employers and fleet providers as part of this review suggested around 90,000 ECOS cars. However, both these estimates depend heavily on which definition of an ECOS car is used in compiling the figures.

Information about the size and number of employers opting for ECOS is also important in understanding what benefit is being provided to employees in running an ECOS scheme. Most of the obvious ways of saving – e.g. bulk purchasing and the ability of a large firm to underwrite insurance or guarantees – are likely to be available only to large employers. However, many respondents declined to provide information on this. The information provided suggests that many employers running ECOS schemes have at least 500 ECOS cars, while a few have in excess of 8,000 cars.

### 3.2 Advantages of ECOS

**Cheaper financing.** As with the car itself, there is scope for an employer or ECOS provider with some market power to obtain a discount on car financing. The employer often assumes responsibility for ensuring the payments under the finance agreement are met. This reduces the risk of lending money to a particular employee, which is reflected in the percentage interest rate that the loan provider is willing to offer.

**Reduced cost of insurance.** It is less likely that bulk purchasing will yield significant discounts in the case of insurance markets, where the industry is likely to be dominated by a smaller number of large firms with significant market power. However, insurance through a fleet policy requires less administration and gives a more accurate picture of risk, so proving a cheaper option than policies obtainable by individuals.

**Maintenance agreements.** Provision of maintenance and servicing is likely to have a fixed cost associated with it, and so there is likely to be some scope for bulk purchasing discount. It is difficult to establish exactly what this represents in terms of saving to the employee; they are effectively purchasing a brand new car at a second-hand price.

### 3.3 Putting a cost on the advantages of an ECOS

Putting a cost on the advantages of an ECOS is difficult because of the variety of schemes available but in many schemes there is clearly some advantage. There is also the advantage to the employee of being freed of any responsibilities of running and maintaining the car that a private car owner would normally have, but quantifying this advantage in monetary terms is difficult.

## Chapter 4

### Interaction of AMAPs with ECOS and CCT

#### 4.1 Effects of the interaction

There is a range of reasons why employers offer ECOS as alternatives to company cars and cash allowances. This Review has indicated that there is a perceived imbalance between company cars, AMAPs and ECOS. The growth of cash allowances could be viewed as a “symptom” of this imbalance. The different tax treatments and administrative arrangements of company and private cars is clearly central to business decisions, but there are other “softer” factors, including the increasing popularity of more flexible remuneration packages, into which ECOS arrangements readily fit, that has also resulted in the fall in company car numbers.

Figure 3 shows some of the reasons why employers have chosen to move away from offering company cars.

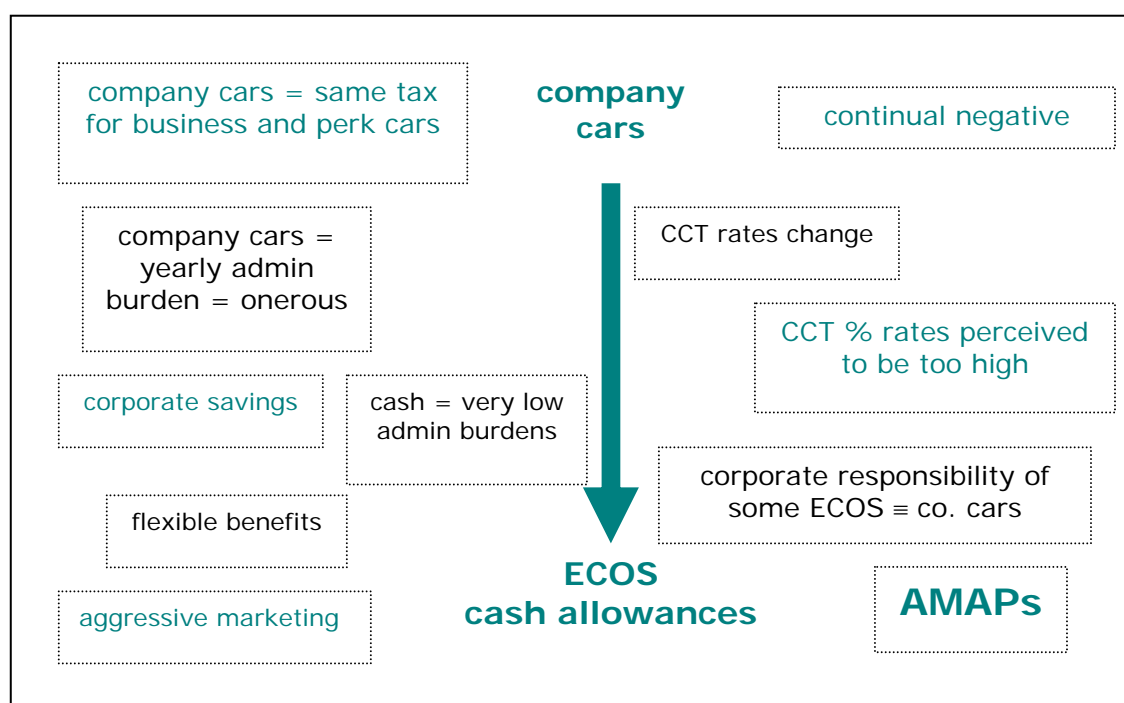


Figure 2 - Reasons why employees and employers choose to leave company cars

One significant reason for the growth in ECOS is attributed by a number of respondents to the CCT reforms in 2002 and the belief that it penalised high mileage drivers, who from necessity of comfort and safety drove high specification cars, often with low fuel efficiency and consequently high emission ratings. However, if this was the full story then, arguably, the potential ECOS market would be limited to this group, but this isn't the case and the reason for the growth in ECOS is the result of the interaction of a number of different factors that include:

- the trend towards flexible remuneration packages; and
- changes to the company car tax regime and AMAPs.

It is this complex interaction that makes it difficult to judge how the ECOS market will develop in the future. A significant number of respondents claimed that the market will remain static or shrink, but others including a major ECOS provider, believes that the market will continue to grow by 10% per annum (although they do not specify the

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period over which they expect this growth rate to be sustained), and several other providers who anticipate steady growth in their individual portfolios.

#### **4.1.1 AMAPs and ECOS**

Respondents to the review were clear that AMAPs are a key factor in the viability of many ECOS. The more structured schemes are predicated on the use of the tax and NIC free element of business mileage to reduce the employer costs of providing a car as part of a remuneration package. For many schemes, the financial viability of the scheme relies on maximising the tax and NIC relief associated with AMAPs<sup>9</sup>, so the rates and threshold of AMAPs exert a strong influence on employers. The opportunity to maximise AMAPs is often one of the main reasons why employers choose to introduce ECOS.

It is important that schemes record mileage correctly. As an incidental finding of the review, it was apparent that AMAPs are not always dealt with correctly and some schemes are in breach of current legislation. For example, there are instances of schemes where an employer averages miles driven across the whole ECOS fleet in order to record the maximum number of miles possible at the full 40p tax free rate. Many employers also kept insufficient data to track cumulative business miles driven by their employees and continue to pay mileage at higher rates regardless of actual miles driven.

From the employer's perspective, the big saving is in using the 40p per mile towards the expense of replacing a company car. Perceptions about the sufficiency of the amount of AMAPs change with the volatility of fuel prices, however at the time of the review, many employees stated that they perceived the AMAPs rate (up to the 10,000 mile threshold that applies for tax), to be quite generous. They viewed the difference between the AMAPs rate and motoring costs as tax and NICs free cash. This meant that the amount of cash allowance paid each month to the employee as additional salary to fund the purchase of the car was reduced and so both the employer's and employee's NIC charge was lower. In addition, any business miles over 10,000 paid at the lower AMAPs rate of 25p are NIC free, provided they are overall no more than 40p per mile, potentially adding to the employer's savings.

#### **4.1.2 AMAPs and other private car users**

AMAPs were also important to other private car users. If an employee believes that his business motoring costs are actually lower than 40p a mile, then the AMAPs rate could encourage driving more miles in order to make a "profit". The perception of AMAPs and whether the driver considers that they have a "profit" element associated with the payment can influence driving habits.

### **4.2 Response to the review into AMAPs**

As announced in Budget 2007, HMRC conducted a review between May and July of that year into changing the structure of AMAPs to ensure the rates and thresholds are set at an appropriate level. The overwhelming response from contributors was not to overturn the deregulatory nature of the current system, the simplicity of which was appreciated by many. Few respondents commented on the level of the rates, although some considered the threshold to be too high, whilst others considered the rates to be

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<sup>9</sup> For example: An employee is entitled to £500 per month made up of an AMAPs amount and a cash allowance which is subject to tax and NICs. If an employee travels 100 miles per month: AMAPs = £40, cash amount subject to tax and NIC £460. If the employee travels 1000 miles per month: AMAPs = £400, cash amount subject to tax and NIC £100.

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insufficient. Overall however there was agreement that few drivers calculated the actual costs per mile of using their own cars for business journeys.

The contributors to the review predominantly accepted that AMAPs have to cater for a wide range of car drivers and broadly strike a balance between giving tax relief for amounts which represent fair recompense for car use, but not for profits. The initial aims of the scheme were to fix a rate to strike an appropriate balance between covering the running costs of all cars, large and small, and delivering the Government's environmental policy. The review showed that although some thought that the threshold level was sufficiently high to produce some unforeseen consequences, such as drivers traveling more miles in older vehicles, there was no consensus on how the scheme could be changed to be fairer to all drivers without a significant increase in administrative burdens.

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## Chapter 5

### Employer considerations

Employers make decisions on business travel policy based on what best serves the needs of their business and employees. There are, however, a range of factors that can influence an employer's decision on travel policy, such as the demands of administration, tax and NICs levels and Health and Safety considerations. The importance of each of these factors will vary depending on whether they apply to company cars, ECOS, or cash allowances. The Government recognises that in formulating tax and NICs policy it is important to consider all options available to employers and how these interact, as employers are free to arrange their business transport needs in the way that suits them best.

#### 5.1 Employee incentive and recruitment

Most participants to the review cited recruitment and retention as a factor in an employer offering a company car, ECOS car, or cash allowance.

Company cars are still considered by many employers as an important part of the recruitment and retention of staff and company cars are still a popular part of employee remuneration packages. However, some employers feel that ECOS fit more easily into flexible remuneration arrangements.

#### 5.2 Choice

Employers felt that the scope for employee choice would depend on the particular scheme. Flexibility was most important in business sectors where there is a shortage of employees with specialist knowledge or skills and the ECOS could be offered as part of a flexible benefit package.

A number of respondents to the review did recognise that company car schemes are equally able to offer flexibility over choice of vehicle. However, this could have an impact on cost if the CCT scheme relied upon bulk purchasing of one model to take advantage of more generous discounts. Other respondents felt that ECOS are, in general, more flexible than company car schemes and offer a wider range of choice, because employees were offered the opportunity to make additional contributions if they wanted to trade-up to a higher specification car.

#### 5.3 Health and Safety issues and corporate liability

Businesses are increasingly aware of their corporate liability for employees who are driving business mileage. Concern over litigation, should an accident occur in an inappropriate or unsafe vehicle, was mentioned by most parties to the review. This factor is seen as an advantage of ECOS over cash allowances and private car use, but is not relevant when comparing ECOS and company cars. ECOS are seen as ensuring more control over the suitability and roadworthiness of vehicles used by employees at work. Newer vehicles are generally safer, and in many cases the arrangements also cover insurance. The regular servicing and maintenance costs built into most ECOS mean that the employer can have more confidence that the vehicle being used is in good condition.

The negative aspects of cash allowances identified during the review focus around the reliability and condition of privately bought cars. The duty of care of an employer to his employees and concern over corporate liability for any damages incurred in an unsafe vehicle used for business travel, are major issues at the current time and some

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employers feel that cash allowances or private vehicles don't offer them sufficient control over the car. Cash allowances, with conditions limiting the choice of car, are paid by some employers to control corporate image and also to give the employer some confidence in the health and safety of their employees travelling on business, but it is by no means the norm.

There is no evidence that driving licences, business insurance cover, the condition of the car and level of maintenance are routinely monitored by employers. Many said that the additional level of administration in introducing checks, along with an appropriate audit trail, was not something they wanted to do, or in some cases felt able to enforce. The introduction of the Manslaughter and Corporate Homicide Act 2007 has encouraged some employers to monitor their grey fleet more closely, but many employers still see the burden as too onerous.

#### **5.4 Control**

Both company cars and ECOS allow, to some extent, the employer to protect the corporate "image" of the company by ensuring that the vehicles its employees are seen to drive for business are of a certain standard, relatively new, well maintained and maybe even a particular brand, colour and status depending on the employee.

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## Chapter 6

### Environmental impact

The current CCT legislation was created to encourage both employers and employees to consider a car with lower CO<sub>2</sub> emissions when they choose a company car because by doing so they can reduce the tax and NICs burden. The second stage of the company car tax reform evaluation suggests that the legislation has achieved this to some extent. However, there is no specific CO<sub>2</sub> based policy to encourage the use of more privately owned, environmentally friendly cars for business although all cars purchased after 20011 are subject to the CO<sub>2</sub> based Vehicle Excise Duty.

#### 6.1 Environmental effects of privately-owned cars

The review highlights that the fuel type and CO<sub>2</sub> emissions of privately-owned cars (including cash allowance cars) are difficult to quantify as this information does not need to be provided by employers. HMRC's views on the environmental impact are therefore based on broad assumptions.

Indications from publicly available figures on privately owned cars are that the average age of such vehicles (estimated at 6.7 years by the Energy Saving Trust) will be higher than those in ECOS or company car schemes. However, the age of cars purchased with a cash allowance may be less than for other privately purchased cars because the combination of a specific car allowance and good finance deals available from many car dealerships may encourage employees to buy a newer car.

Responses during the review also showed that in many cases cash allowances are seen by employees as a potential opportunity to acquire an older but higher specification car, which the employee would not have been entitled to under the CCT scheme or been able to afford as an ECOS car. These types of car may, as a result, have higher CO<sub>2</sub> emissions.

Some ECOS and cash allowance schemes include incentives, or conditions, which encourage owners into purchasing cars that are less environmentally damaging through age or CO<sub>2</sub> emission rates or both.

##### 6.1.1 Carbon emissions of ECOS

The initial findings from the review of ECOS in June 2006 suggests that, an average ECOS vehicle has higher levels of CO<sub>2</sub> emissions than an average company car by around 20g/km. This does not necessarily mean that an employee leaving a company car scheme for an ECOS will choose a car with emissions of 20g/km higher; what it means is that comparing the whole ECOS fleet with the whole company car fleet, the ECOS fleet is, on average, 20g/km higher with average emissions of ECOS at around 195g/km compared with company car averages of between 170 – 175g/km<sup>10</sup>. The data provided also suggests that ECOS are more likely to be in the top CO<sub>2</sub> bands when compared with company cars.

Some ECOS are managed with the environment in mind and as a result have similar or better CO<sub>2</sub> emissions to comparable company car fleets. To some extent, the fact that the average ECOS appears to have higher emissions is not unexpected as CCT is perceived as unfair on high business mileage drivers who need higher specification cars

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<sup>10</sup> Based on the latest National Statistics for company cars – 2004/05

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for safety and comfort amongst other things, and are therefore most likely to consider ECOS as an alternative.

The 20g/km figure was quoted in the Pre-Budget Report of 2006, and was challenged by a significant number of respondents in the second series of meetings. A number of employers stated that they operated ECOS which they believed were roughly equal in levels of CO<sub>2</sub> emissions to the company car fleet that they had previously run. Moving from a company car fleet to an ECOS fleet does not mean that the ECOS fleet will always have higher CO<sub>2</sub> emissions. The CO<sub>2</sub> emissions of the fleet as a whole will depend on a number of factors including the conditions relating to choice of car and the choice employees make.

### **6.1.2 Carbon emissions of other privately-owned cars**

There is no data available on the emissions of other private cars used for business travel although it seems fair to say that, on average, they are likely to be higher compared with company cars. Discussions in January 2007 with the fleet industry revealed conflicting views. Some felt that where employees are given a cash allowance and he or she buys a car, he may choose a newer car because of the finance deals that are available to the public. In contrast however, other contributors thought that where companies do not offer either company cars or ECOS, but give cash as part of the remuneration, employees are more likely to buy older, less green vehicles, either to acquire high status cars more cheaply, or to retain as much of the car allowance as possible for other areas of personal expense.

Cash allowances are often seen as popular by those who wish to drive a larger engine vehicle which would be prohibitively expensive under CCT, and have a high cost if bought new through an ECOS. This may have the effect of increasing CO<sub>2</sub> emissions as employees buy older vehicles where technology is less advanced and wear and tear has reduced the efficiency and cleanliness of the engine.

From an environmental perspective, the Government currently influences an individual's choice of private car through Vehicle Excise Duty charges linked to CO<sub>2</sub> emissions, and the price of fuel. If the individual drives business miles for his or her employer then the levels of AMAPs may also be a factor.

The review suggests that the wider environmental implications of ECOS are difficult to interpret as there is conflicting information. Some schemes have ECOS cars with CO<sub>2</sub> emissions comparable to previous company car schemes. However, some ECOS are clearly aimed at ensuring that employees can choose top of the range, high CO<sub>2</sub> emission cars without incurring the additional company car benefit cost.

Many companies operating ECOS consider them to be more environmentally friendly than cash allowance schemes and do not think that ECOS automatically lead to higher CO<sub>2</sub> emissions. Encouraging employees to drive business miles in newer cars has a positive impact on the environment compared to the same miles driven in employees' own cars obtained outside ECOS, although possibly not when compared to company cars.

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## 6.2 The environmental effect of business mileage in the public sector

High levels of business mileage can be unavoidable in some public sector jobs<sup>11</sup> and as a result some departments provide a company car (normally a lease car) for employees travelling over a certain number of business miles a year. These schemes can have a beneficial impact on the environment as most are new cars and there are often limits on the maximum CO<sub>2</sub> emissions that a car can have. They usually involve employers paying a contribution towards the lease costs dependent on the employee's role, status or annual mileage. The employee pays a contribution to cover the private use of the vehicle and the private use is taxed as a company car benefit-in-kind. There are a limited number of these cars as they are often only available if the employee drives more than 8,000 miles a year.

For many others however, the option of a lease car is not available and they are required to use their own cars for business journeys. Control over the emissions and fuel efficiency of these cars is almost non-existent as employees choose their own car for lifestyle reasons and not for business purposes. For some of these drivers the perception was that they were subsidising their employer. However, most drivers who were questioned during the review were unaware of the true costs of running a car as the relevant records to calculate their actual expenditure are not kept.

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<sup>11</sup> The Office for Government Commerce is currently working with a number of Government departments, and wider public sector organisations, to develop some common standards for public sector employees travelling business miles. Based on the environmental, social and financial impacts of driving business miles, these standards will aim to bring consistency across public sector organisations and will cover minimum standards for vehicles used for business purposes and restrictions on the use of grey fleet vehicles.

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## Chapter 7

### Other Considerations

#### 7.1 Administration Burdens

There are different types of administration burdens associated with CCT, AMAPs, ECOS and cash allowances and these administrative burdens or perceived burdens can encourage employers to choose one method over another.

Although the administration costs (in terms of labour and record keeping) are similar for ECOS and company cars, employers may be more prepared to meet these costs because of the perceived tax and NICs savings associated with ECOS.

The mandatory reporting requirements for company cars are seen as costly in terms of both time and labour and as a result many employers considered ECOS a less costly option. By moving from company cars to other options employers can avoid this requirement. However, respondents to the review did recognise that ECOS had their own administrative burdens if they are operated correctly. The discussions held with industry suggest that, although the cost of the administrative burden of running a company car scheme and an ECOS may in fact be similar, employers view the admin burden requirements differently.

Employers also felt that because the reporting for company cars is annual and creates one large work peak per year, it is more difficult and costly to deliver than the lower, monthly level of administration as a cash allowance scheme is the easiest and cheapest option for most employers. Cash allowances are often less than the employer's cost of providing a company car; they are treated as additional salary and therefore have no additional administration costs associated with them.

Many employers felt that a major advantage of AMAPs was that the rules were simple to operate and the feed-back on amending the rates and thresholds was that any changes should still maintain the current simplicity. The overwhelming view from employers who responded to the AMAPs review was that AMAPs were easy to operate as they were not linked to the car and the only records required were mileage details. Moving to an AMAPs system based on CO<sub>2</sub> emissions, although seen as consistent with other types of Government taxes on business travel, would be too burdensome for employers to operate or police. The level of control over payment of AMAPs was generally found to be quite low, although some employers were reviewing their systems as they became more aware of their responsibilities over duty of care (see section 5.3).

#### 7.2 Fiscal Impacts

One of the findings of the second stage review of the 2002 CCT reform was that it caused a reduction in tax and NIC collected from company cars. In theory, if the number of employees receiving cash allowances increased this would raise additional funds for the Exchequer if the full value of the cash allowance is subject to tax and NICs. In practice, however, it is difficult to quantify the overall effect, particularly given the interaction with AMAP and the fact that employers can use them to mitigate the tax and NICs burden in a similar way to ECOS.

As employers have to pay Class 1A NICs and employees have to pay income tax on the provision of company cars, many businesses see not having to pay tax and NICs as a substantial advantage. As a result AMAPs are considered by many as being more advantageous.

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There are a number of reasons for this:

- the most costly business miles are the first 1,000 miles. Arguably, therefore, AMAPs have a built in incentive to drive additional business miles;
- however, the older the privately-owned car, the greater the profit or compensation element associated with AMAPs because the car is no longer on a steep depreciation curve; and
- AMAP rates are also attractive to employees who drive high business miles compared to CCT where there is no longer the opportunity to reduce the tax and NICs burden for high mileage business drivers.

This suggests that to an extent the current AMAP structure offers a perverse incentive to drive higher miles in older, more polluting cars. The rates and thresholds make many ECOS schemes financially viable as the high threshold and AMAP structure make it possible to mitigate the tax and NIC element of any cash allowance. For drivers who drive relatively few miles in newer cars however, the rates are perceived to be insufficient.

### **7.3 Interest free loans**

Under existing legislation an employer can make an interest free loan to his employee of up to £5,000 without incurring any charge to tax or NICs. Although interest free loans are often used for purchases connected to the employment, there is nothing in legislation to restrict what a loan may be used for. Some ECOS make use of the interest free loan to fund an initial payment towards the price of the new vehicle. Evidence from contributors to the review suggests that this is less attractive as a method of making tax savings when the available market interest rate for loans is low. Savings are greater when the interest rate on finance to pay for the car's purchase is higher. However, there are a number of ECOS where the use of interest free loans is a key element of the scheme.

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## Chapter 8

### Conclusions

The findings in this report clearly demonstrate the interaction between company cars, ECOS and mileage payments made to employees who use their own cars for business use. The introduction of the emission based company car tax rules in 2002 led to an increase in popularity for employee car ownership schemes particularly at the top end of the company car market.

Employers are able to choose a number of alternatives for business travel and the decision is based on a number of different factors. The move in recent years to more flexible benefit packages reflects the increased choice for motorists that is now required to retain and recruit talented staff. Taxation issues and the administrative burden of running and maintaining company fleets are also important factors, but the introduction of the Manslaughter and Corporate Homicide Act 2007 has also had an impact. The duty of care of an employer to his employees has highlighted many issues with the grey fleet – i.e. drivers who use their own cars for business journeys - but this has not yet diminished the popularity of cash allowances or led to a significant move back into company cars.

### ECOS

ECOS can be a more tax and NICs efficient alternative to company cars for higher rate taxpayers undertaking high business mileage in the most polluting cars. It is also fair to say however that many ECOS cars have similar CO<sub>2</sub> emissions to the equivalent cars available as company cars. The ECOS market, however, is ultimately limited by the tax efficiency of these schemes in comparison to the more traditional company car. If they are not tax efficient there is less incentive for employers to provide the option.

Many ECOS are designed to maximise the tax and NIC free AMAPs regime. As a result there can be a built-in incentive for employees to drive more business miles than may be strictly necessary, to the detriment of the environment. This is the very behaviour that the removal of the mileage thresholds in the CCT reforms in April 2002 sought to address.

### AMAPs

The flat rate mileage payments (AMAPs) for owner drivers can be generous for those with older cars driving high business mileage but less so for drivers with newer cars with low business mileage. The system is simple to operate and easy for employers and employees to understand, so the deregulatory nature has outweighed the disadvantages. The extent of this impact will clearly be influenced by the AMAP rates that are set. The Government believes there is undoubtedly an advantage for some employees in joining an ECOS but putting a value on this is difficult because of the variation. Given the interaction between CCT/AMAPs and ECOS it is difficult to assess whether the ECOS market is shrinking, growing or static.

An announcement was therefore made in the Pre-Budget Report 2007 not to impose a new tax specifically on ECOS, but the Government will monitor growth in this sector and how it impacts on other changes in the taxation of business cars. The overwhelming response from correspondents to the review into AMAPs was that the current system is simple to understand and easy to administer. Many thought that the threshold was too high, but few comments were received on the rates themselves although there was an understanding that the rates have to cater for a wide variety of drivers.

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There is a mismatch between the tax and NICs treatment of AMAPs as NIC does not have a threshold at 10,000 miles. This is exploited by some to maximise the use of AMAPs paid to drivers of ECOS or those funded by cash allowances. There is also a discrepancy in the treatment of private fuel for company car drivers and owner-drivers. Legislation provides for a company car fuel benefit charge based on the CO2 emissions of the car and a fuel "multiplier". The provision of private fuel for those driving their own cars however reverts back to the general rule that tax and NICs are due on an amount equivalent to the cost to the employer of providing the fuel. The increasing price of fuel however makes the provision of free fuel an expensive option for the employer and therefore we would expect this benefit to decrease in future years.

### **Government Announcements**

In light of the findings of this review, the Government decided at Pre-Budget Report 2007:

- that a new tax on ECOS would not be introduced at this time, but that HMRC keep a watching brief on how the market develops;
- that the structure of AMAPs should not at this time be revised to reflect CO2 emissions as employers are happy with the current system and like its simplicity. In Budget 2008 the Government announced that the current rates and threshold would be maintained, but the mismatch in the treatment of tax and National Insurance will continue to be monitored, in light of the outcome of the payrolling consultation<sup>12</sup>; and
- for the future the Government will consider ways of simplifying CCT to ease the burden of administration for employers.

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<sup>12</sup> HMRC have recently issued a consultation on the payrolling of expenses and benefits in kind.

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## Appendices

**Appendix A:** text of open letters published on the internet in May and December 2006

**Appendix B:** classifies the businesses and organisations that took part in the meetings in June and December 2006 and the AMAPs review in July 2007.

**Appendix C:** provides an overview of how company car tax works

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## Appendix A: Text of letters published on the HMRC internet

### First Open letter of invitation - published 8 May 2006

#### REVIEW OF EMPLOYEE CAR OWNERSHIP SCHEMES

This note sets out how HMRC propose to take forward the review of Employee Car Ownership Schemes (ECOS) announced by the Government at Budget 2006.

#### Aim of the review

The aims of the ECOS review are to build the evidence base on:

1. How ECO schemes work (including financial arrangements);
2. What the factors are that have contributed to the expansion of these schemes;
3. What the impact of ECOS has been on carbon dioxide (CO<sub>2</sub>) emissions and local air quality compared with company cars;
4. Whether ECOS offer an advantage to employees or employers that should be taxed (and subjected to NIC) as a benefit-in-kind and if so how; and
5. The wider impact that such a charge might have, for example on ECO schemes themselves or on the used car market etc..

#### Background

6. ECOS, at its most basic, is a scheme facilitated by employers that enables an employee to acquire a car, often within a specified finance framework.
7. On 22 March 2006 the Government announced a review of ECOS in paragraph 7.79 of the 2006 Budget Report:

*... In light of the findings from the company car tax evaluation that show a rise in the number of employee car ownership schemes (ECOS), HM Revenue & Customs will review the taxation of ECOS and benefits employees derive from them, with a view to possible changes."*

#### Company car tax evaluation: second stage

8. The second stage review of the company car tax evaluation was also published on Budget day and can be found at <http://www.hmrc.gov.uk/budget2006/company-carevaluation.pdf>. The review identified that there has been a reduction of about 400,000 company cars since 1999. The biggest single reason cited for opting out of company cars was the real, and perceived, impacts of the 2002 reform.
9. Where employees have chosen to opt out of company cars, some are offered alternatives and one of the alternatives that is offered can be for the employee to enter into an employee car ownership scheme.
10. The report estimates that around 150,000 employees have cars through ECOS.

#### What HMRC are seeking from the review

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11. HMRC are seeking information and documentary evidence on the following areas:

- The numbers of employees in ECOS and how they might change in future.
- Types of cars in ECOS, their CO2 emissions and whether they have a greater environmental impact compared to the company cars employees might otherwise have chosen.  
The different types of ECOS and what distinguishes them, including concrete examples.
- The advantages to employees of entering into ECOS.

### **How HMRC will use the information**

12. HMRC will use the information to consider the argument for and against taxing (and subjecting to NIC) the advantage that an employee or employer derives from ECOS.

### **How HMRC intends to undertake the review and who it is aimed at**

13. HMRC are seeking representations from a wide range of organisations with an interest in ECOS. HMRC will hold a series of meetings on 6, 7 and 27 June 2006 with interested parties. The aim of the meetings will be to discuss ECOS in the wider context, specifically focussing on the requirements of the review highlighted in paragraphs 11 and 12 of this note.

14. Interested parties should e-mail [pa.harris@hmrc.gsi.gov.uk](mailto:pa.harris@hmrc.gsi.gov.uk) specifying which date or dates they would prefer.

15. HMRC will report progress at the time of Pre-Budget Report 2006.

### **Second Open invitation - published 14 December 2006**

The following is the text of the open invitation that was published on the HMRC website on 14 December 2006.

### **FURTHER DISCUSSIONS ON THE INTERACTION BETWEEN COMPANY CAR TAX, TAX-FREE MILEAGE ALLOWANCES AND EMPLOYEE CAR OWNERSHIP SCHEMES**

This note sets out how HM Revenue & Customs (HMRC) proposes to handle the extension of the review of Employee Car Ownership Schemes (ECOS) and further consider the interaction between Company Car Tax (CCT), ECOS and Approved Mileage Allowance Payments (AMAPs). These further discussions with industry were announced in Pre Budget Report 2006 and will be held during January 2007.

### **Aims of the further discussions**

HMRC would like to meet with a wide range of interested parties to look at this interaction and how it drives business considerations. The following gives some broad aims to these further discussions.

Explore whether, and if so how and why, the composition of fleets have changed since the second stage of the evaluation report into company cars, which can be found at <http://www.hmrc.gov.uk/budget2006/company-car-evaluation.pdf>  
Consider the factors that have contributed to employers choosing an alternative to the company car;

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Explore the extent that tax/ NICs considerations played a part in this;

Explore what aspects of CCT cause employers most difficulty to administer and why;

Examine how businesses use mileage allowances to deliver business objectives.

## Background

On 22 March 2006 the Government announced a review of ECOS in the 2006 Budget Report; the following was included in the Pre-Budget Report published on 6 December 2006:

*"... HMRC have undertaken extensive discussions with business which have indicated that there are a number of different ECOS schemes some of which have been designed to provide an ongoing benefit to employees that are currently not taxed or subject to NICs; and that the carbon emissions of an average ECOS car are around 20g per kilometre higher than an average company car. Furthermore there is a noticeable interaction between the tax treatment of ECOS, tax-free mileage allowances and rates of company car tax which may have contributed to the popularity of ECOS. HMRC will hold further discussions with industry in January 2007."*

## What HMRC are seeking from further discussions

As well as meeting with representatives from industry and business, HMRC are also seeking specific information, which is outlined in the Appendix to this letter. The Government will use the findings of these discussions to consider whether changes are necessary to strengthen environmental incentives and protect Exchequer revenues.

## How HMRC intends to undertake these discussions and who they are aimed at

HMRC are seeking views from a wide range of organisations with an interest in company cars, employee car ownership schemes and mileage allowances. HMRC will hold two hour meetings as follows:

### London

8 January 10.30 am – 12.30 pm  
14.00 pm – 16.00 pm

9 January 14.00 pm – 16.00 pm

### Birmingham

16 January 10.30 am – 12.30 pm  
14.00 pm – 16.00 pm

If you wish to be involved in these discussions please e-mail [pa.harris@hmrc.gsi.gov.uk](mailto:pa.harris@hmrc.gsi.gov.uk) specifying the time and date or dates you prefer as soon as possible. **Places will be allocated on a first come basis.**

These meetings will involve a brief ten minute presentation by HMRC followed by an open discussion with participants.

## APPENDIX

This appendix contains some questions, in response to which it would be helpful if you could provide as much specific raw data as possible.

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Please will you send any written responses and data (preferably in Excel format) to [pa.harris@hmrc.gsi.gov.uk](mailto:pa.harris@hmrc.gsi.gov.uk) by **19 January 2007**.

Any information you provide will be treated as confidential to the review. In particular, it will not be made available to other HMRC staff who are unconnected with the review. In the following questions we have used "company car"; "employee car ownership scheme" and "cash allowance" to mean the following:

**Company car:** a car where company car tax is charged on the employee

**Cash allowance:** an allowance provided to an employee in lieu of a company car where there is no requirement to use the allowance to purchase a car

**Employee car ownership scheme:** any arrangement between an employee and employer where the employee purchases a car and that arrangement is not a straight forward cash allowance arrangement as defined above.

1. How many company cars, ECOS and cash allowances do you have in your fleet?
2. Do you offer your employees a cash alternative to a company car? If so, is a condition of the allowance that it should be used to purchase a car? Can your employees choose whether to take a company car or the cash alternative or do you impose conditions on this choice, if so what are they?
3. If you offer a cash allowance, how much do you offer and how does this compare to the list price of the company car the employee would have otherwise received?
4. If your employees choose to buy a car with their cash allowance do you know the fuel type and emissions of the car? Please provide specific details if possible.
5. Do the following types of employees use their cars for business travel and how much business travel do they do per year?
  - a. employees with ECOS cars
  - b. employees with cash allowances
  - c. employees with neither an ECOS car nor cash allowance
  - d. employees with company cars
6. Do you pay mileage allowances to other employees who do not have either a cash allowance or an ECOS car?
7. What rate of mileage allowances do you pay your employees and how did you arrive at this amount? Please provide specific details if the rates vary for different types of employee.
8. How do you pay your employees mileage allowance? Do you reimburse business mileage actually driven by the employee; pay on the basis of estimates or pay business mileage in advance and reconcile at the year end? Please provide specific details if the method varies for different types of employee.
9. Do your employees think that the current approved mileage allowance rates (AMAPs) are generous, and what motoring costs do they take into account when they consider this?
10. Does your company provide fuel for private use for:
  - a. employees with company cars?
  - b. employees with ECOS cars?
  - c. employees with a cash allowance?
  - d. employees who do not fall into categories a – c above?

### Third Open letter - published in May 2007

The following is text of an open letter published in May 2007 on the HMRC website

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## FURTHER DISCUSSIONS ON APPROVED MILEAGE ALLOWANCE PAYMENTS

As you are aware, HM Revenue & Customs (HMRC) review of Employee Car Ownership schemes (ECOS) and the interaction with company car tax and mileage payments is still on-going. The announcement in Budget 2007 stated that

*"the Government will consider the case for changing the structure of AMAPs to align the tax and NICs treatment and ensure that the rates and thresholds are set at an appropriate level to promote environmentally friendly business travel"*

As part of this process, HMRC are now looking at possible ways that the current structure of Approved Mileage Allowance Payments (AMAPs) might be changed. We are looking in particular at

- Whether the rates and threshold can be adjusted to better reflect differing costs of drivers using their own cars for business;
- Whether the structure can be changed to encourage drivers to be more environmentally aware, and
- Whether the tax and NICs rules can be aligned for mileage payments.

HMRC would welcome comments on three possible approaches and how these might work in practice. Although the scenarios do include specific rates and thresholds, **these are for illustration purposes only**. Employers are welcome to comment on the rates and thresholds, but *HMRC would also like views on the administrative burden that may arise from such changes*. As mileage allowance payments are used by a large number of employers, HMRC would like responses from as broad a spectrum of employers as possible. We considered various methods of notifying employers about this stage of the review and have taken the opportunity provided by Fleet News to publish an article on our behalf. We will also be publishing an open letter carrying the same message on the internet in the next couple of days.

### Possible changes that could be made to AMAPs

#### Linking AMAPs to CO<sub>2</sub> emissions

The aim of this scenario is to explore how AMAPs could be tied to more environmental incentives to reduce CO<sub>2</sub> emissions. Given the interaction between company cars, ECOS and mileage payments highlighted by the review so far, a possible approach would be to link the AMAP limits to the CCT lower threshold. One example of how this could work would be:

- 50p per mile for cars within the 15% company car tax band or lower (currently 135g/km) up to 10,000 mile threshold
- 40p per mile for cars within 16% - 25% band (currently 140-185g/km) up to 10,000 mile threshold
- 25p per mile for cars over the 25% band; all cars with no CO<sub>2</sub> emissions and all cars over 10,000 miles.

#### Amending the rates and thresholds

It may be possible to amend the rates and thresholds to better reflect the differing needs and costs of drivers using their own cars for business mileage and to reflect, in particular, the high initial costs of drivers using their own car for business purposes. The following rates and thresholds are purely illustrative but are intended give an idea of how the current rates could be changed: One option might be

- 50 per mile for 1,000 miles
- 40p per mile for the next 5,000 miles

- 
- 25p per mile thereafter

Or another

- 50p per mile for 2,000 miles
- 40p per mile for the next 4,000 miles
- 20p per mile thereafter.

Combining the two suggestions for a more composite approach linking both environmental issues and more

A further possibility may be to combine both a CO<sub>2</sub> emission based approach with a change to both rates and thresholds, the aim being to provide an environmental incentive, whilst recognising the higher initial costs. This may look something like this:

- 55p per mile for cars within the 15% band or lower up to 5,000 miles
- 40p per mile for cars within 16%-25% band up to 5,000 miles
- 25p per mile for cars over the 25% band; cars with no CO<sub>2</sub> emissions and all cars over 5,000 miles.

HMRC would welcome views from all representatives from industry and business with an interest in company cars, employee car ownership schemes and mileage allowances. If you wish to comment, please send your contributions to [pa.harris@hmrc.gsi.gov.uk](mailto:pa.harris@hmrc.gsi.gov.uk) by **31 July 2007**.

## **Appendix B: List of attendees**

### **Meetings in January 2007**

Trade bodies and trade representatives	8
Accountancy	8
Consultants	26
Employers running schemes	5
Car manufacturers	4
Public sector	29

### **Meetings in June 2006**

Trade bodies and trade representatives	6
Accountancy	4
Consultants	12
Employers running schemes	6
Car manufacturers	3

## **Appendix C: Outline of the taxation of company cars**

### **Previous company car tax system**

The company car tax system prior to April 2002 was based primarily on the list price of the car and the annual level of business mileage done by the company car driver. The basic calculation of the taxable value of the car benefit was:

- 35% of the list price of the car if less than 2,500 business miles were done in the tax year;
- 25% if 2,500 to 17,999 business miles were driven; and
- 15% if 18,000 or more business miles were driven.

If the company car was four or more years old at the end of the tax year, the taxable value of the car benefit for the appropriate business mileage band was reduced by a further 25%.

Company car drivers were liable to pay income tax on the taxable value of the company car benefit at the appropriate marginal rate(s). Their employers were liable to pay Class 1A NICs on the same amount. This system encouraged some employees to drive more business miles than they otherwise would have so that they could exceed the 2,500 or 18,000 mile thresholds and therefore pay less tax. This was environmentally damaging and contributed to increased congestion on the UK's roads. There were no explicit incentives in the system for drivers and employers to choose company cars that produced relatively low levels of harmful emissions (although cars with low list prices generally produce lower levels of CO<sub>2</sub> emissions than those with higher list prices).

### **Current company car tax system**

The current company car tax system was intended to address these environmental shortcomings. For the large majority of company cars it is based on the CO<sub>2</sub> emissions that the car produces; the business mileage thresholds that were a feature of the old system were removed. For company cars that run solely on petrol or diesel, the percentage charges applied to the list price of the cars still range between 15% and 35%, as was the case before. However the exact percentage used in the calculation is determined by the approved CO<sub>2</sub> emissions figure for the car, rounded down to the next 5g/km (e.g. emissions of 169 g/km were treated as 165). In 2002/03 the rounded CO<sub>2</sub> emissions figure had to be 165g/km or less for the car to qualify for the 15% charge level. This "lower threshold" level was reduced to 155g/km for 2003/04, 145g/km for 2004/05, 140g/km for 2005/06, 2006/07 and 2007/08, 135g/km for 2008/09 and 2009/10. It will be reduced to 130g/km in 2011/12. For each additional 5g/km by which the CO<sub>2</sub> emissions figure exceeds the lower threshold, the percentage charge increases by 1% until the level at which the maximum 35% charge applies is reached.

Cars with emissions of 120g/km or less are taxed at 10%.

Diesel cars incur a 3% supplement to the percentage charge to reflect that they often produce higher levels of harmful local air pollutants such as particulates and nitrous oxides. However this diesel surcharge is waived for diesel cars that meet the Euro IV emissions standards (a measure of cleanliness set down in an EU-wide directive) if the

cars were first registered<sup>13</sup> before the Euro IV standards become mandatory from 1 January 2006 onwards.

Company cars running on alternative fuels qualify for reductions in the percentage charge as they produce relatively lower levels of harmful emissions. The current reductions are 2% for cars manufactured to run on Liquid Petroleum Gas or Compressed Natural Gas, 3% for hybrid electric cars and 6% for electric only cars.

The reduction for older company cars available under the previous system was removed, as older cars tend to produce higher levels of harmful emissions than newer equivalents.

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<sup>13</sup> The 3% diesel surcharge will apply for diesel cars meeting the Euro IV emissions standards from the 2006/07 tax year onwards if they are first registered after the Euro IV emissions standards become mandatory for new cars on 1 January 2006. For tax years before 2006/07 the 3% diesel surcharge was waived for all company cars meeting the Euro IV emissions standards.