

AN ENVIRONMENTAL AND REGULATORY IMPACT ASSESSMENT

INCOME TAX AND COMPANY CARS : A MAJOR REFORM

The purpose and intended effect of the reform

1. In his March 1999 Budget, the Chancellor announced a fundamental, revenue neutral, reform of the taxation of company cars to help protect the environment. This followed a decision to review the existing regime in the light of criticism of its inherent perverse incentives to drive extra, unnecessary business miles. Details of how the reform will work in practice have been announced in Budget 2000 (see Budget Day press release REV6). The objectives of the reform are to:

- remove any incentive to drive extra miles;
- give employers and employees a tax incentive to choose more fuel efficient cars; and
- encourage manufacturers to produce cars with lower carbon dioxide (CO₂) emissions.

This will help tackle congestion and global warming and improve local air quality.

An assessment of the environmental benefits of the new system

2. The new system for charging company car tax by reference to CO₂ emissions is expected to have a significant effect on environmental emissions over the medium to long term.

3. The abolition of the existing business mileage regime is estimated to reduce total business mileage by around 100 million to 300 million miles. The associated reduction in CO₂ emissions as a result is estimated at around 0.03-0.09% of total transport CO₂ carbon emissions. These estimates are based on a detailed analysis of company car mileage information from the latest National Travel Survey. This shows evidence of bunching of company car mileage just above the critical 2,500 and 18,000 business miles thresholds. The estimates assume that a proportion of these miles are directly attributable to the tax discounts available under the existing tax system at these threshold points.

4. This effect, however, is dwarfed by the expected CO₂ reductions from the additional fuel efficiency gains and downsizing effects of the new regime. These are estimated to reduce total CO₂ carbon emissions from the overall car stock by around 0.5-1MtC (million tonnes of carbon) in the medium to long run, which is consistent with a saving of around 1.5% - 3% of total carbon emissions from road transport in the medium to long term. These estimates give a broad indication of the likely emission savings from the new regime based on our initial analysis of the market in 2002.

5. Our analysis of the CO₂ savings from the new regime assumes that manufacturers will continue to improve new cars such that the average CO₂ emission

rating of company cars will fall by around 2% per annum between now and 2002. The approach we have adopted then attempts to calculate the savings from the new regime by applying the incentive for fuel efficiency and downsizing inherent in the new system to the estimated average fuel efficiency of the company and ex-company car stocks in 2002, adjusting for differences in engine size, age and miles driven. The estimates therefore take account of the expected knock-on effect fuel efficiency improvements in the company sector are likely to have on the private stock in the medium to long run, as company cars filter through to the private, second-hand market over time.

A summary of the employer compliance costs and benefits of the new system

6. The new system will be simple to understand and easy to operate. Employers will only need to establish the list price (as now), fuel type and the CO₂ emissions level when the car is first made available as a company car to be able to calculate the tax and Class 1A National Insurance contributions (NICs) due. This means that, in most cases, the exact tax consequences can be ascertained at the outset, by reference to readily available information, rather than having to wait until the end of each tax year. The requirement to keep records of business miles for tax purposes will disappear.

7. Employers will be newly required to establish and report the CO₂ emissions level of their company cars. They will also have to report the type of fuel used by the car. Employers will need to alter their business records to enable them to hold this data and return the necessary information to the Inland Revenue. They will also need to be able to make the necessary benefit in kind calculations from this data to make Class 1A NICs payments. Changes will be necessary to P11D substitutes to accommodate the new system.

8. Overall, once the new system is in place, employers will need to keep considerably less records than at present.

Cost/Yield

9. Our estimates show that, after behaviour, the reform will be broadly revenue neutral in its first year (2002-03) and have a cost of around £25 million in 2003-04 and around £75 million in 2004-05. These estimates are uncertain, particularly because of the scale of anticipated changes in behaviour.

Sectors affected:

10. All 1.75 million company car drivers, all employers who provide company cars (approximately 250,000) and UK car manufacturers.

How will businesses be affected

Employers

11. *CO₂ emissions* : there will be a new requirement on employers to obtain and report CO₂ emissions data for each company car. For all cars first registered from at

least 1 November 2000, the definitive CO₂ emissions figure for tax purposes will be recorded on the Vehicle Registration Document (V5). Under an agreement with the Inland Revenue, the Society of Motor Manufacturers and Traders (SMMT) is providing a CO₂ emissions enquiry service over the Internet at www.smmt.co.uk for cars first registered from January 1998. A free booklet of indicative CO₂ emissions for every new car on sale in the UK ("New Car Fuel Consumption and Emissions Figures") is available from the Vehicle Certification Agency (VCA) in Bristol or on the Internet at www.roads.detr.gov.uk/vehicle/fuelcon/index.htm.

12. *Diesel cars* : as a diesel supplement is to be levied, employers will need to establish whether their company cars are petrol or diesel. This will be readily done by reference to the V5 or leasing documents. Provisions are being introduced later to allow a lower tax charge for very low emission diesels, and guidance will be issued to employers in due course on the identification of these cars

13. *Alternative fuels and technologies* : provisions are to be introduced to allow discounts for electric cars and cars that run on a combination of petrol and gas or electricity. Employers will be able to identify most such vehicles from the vehicle type descriptions on the V5. The discounts will prevent there being a tax barrier to the take up of such cars, given their higher list price.

14. *Older cars* : for cars first registered before January 1998, the tax charge will be based on engine size as there are no reliable sources of CO₂ emissions data before this date. This will place a new requirement on some employers who supply these older cars to return engine cylinder capacity information to the Revenue (those employers who currently provide free fuel already have to return this information).

The effect on car manufacturers

15. The reform of company car taxation, and the linked reform of Vehicle Excise Duty (VED) will increase the demand for fuel efficient cars with low emissions. The effect on manufacturers' businesses will depend on the level of this demand, and how well manufacturers are placed to respond quickly to meet it. One reason why the reform was announced in Budget 1999, fully three years before implementation, was to give manufacturers plenty of advance warning and time to prepare for the change.

16. Moreover, the reform goes with the grain of the agreement, made in 1998, between the European Automobile Manufacturers' Association (ACEA) and the European Commission to reduce CO₂ emissions from new cars. Manufacturers signed up to a voluntary target of 140g/km CO₂ as the average level of CO₂ emissions from new cars by 2008, with an interim target of 165-170g/km by 2003. Similar agreements have been reached with Japanese and Korean manufacturers. The technological advances that will be necessary, if manufacturers are to meet these targets, will be supported and encouraged by the company car and VED reforms.

17. Some increase in the number of company cars is expected as a result of the reform. In addition, the abolition of the age related discount is likely to mean the demand will be for new (rather than second hand) company cars. Both of these effects will benefit car manufacturers.

18. Car manufacturers have been obliged to record and report CO₂ emissions data to the VCA for all new cars on sale since January 1998. Increasingly, customers will want access to that data and the Association of Car Fleet Operators has been working to raise manufacturers' awareness of this by organising seminars, which government officials have also attended. Some manufacturers already make the data available to customers in their sales brochures. In addition, the SMMT launched an environmental labelling initiative in December 1999 to provide better and more consistent information for customers on the environmental performance of new cars. The labels list data including fuel efficiency and CO₂ emissions, and are on display in car showrooms throughout the UK. The Inland Revenue, in conjunction with the SMMT and the Department of the Environment, Transport and the Regions, has been holding discussions to decide how best to make manufacturers' CO₂ data available to customers via the Internet. As a result, under an agreement with the Revenue, the SMMT is providing a CO₂ emissions enquiry service over the Internet for all cars first registered from January 1998.

Recurrent and non recurrent costs/ savings

19. *Non recurring costs* arise from: the setting up and transitional costs of moving to the new system; management and staff training; familiarisation time; changes to computer software; procurement of CO₂ data and some other management/ human resources overhead. A detailed bottom-up view of costs was established by reference to the number of employers with one or more P11Ds for a car (see **Table 1**). For the 500+ employer size range, one-off costs of typically £ 6,000 to 7,000 were thought likely, declining to about £1,300 on average for the 100 to 499 employer size range. The smallest (1 to 4) employer would probably have only one car and this is assessed as requiring a one-off compliance cost of some £30 to £40 (typically a third party accountant's charge for advice and handling the P11D in the first year). Overall, the total one-off cost for the affected 250,000 employers is estimated to be about £50 million.

20. *Recurrent cost savings* arise because the reform abolishes the requirement for the annual business mileage data to be recorded and provided centrally within the employer's system for the P11D purpose. This has been seen by many as a time consuming and error-prone process; the abolition of this requirement and the substitution of an invariant car parameter based on the CO₂ level is fundamentally a much simpler process.

21. *Recurrent savings* : there is no need to keep ongoing records of business mileage in order to calculate Class 1A NICs or complete P11Ds. The gross compliance savings from the abolition of the mileage requirement are estimated to be worth about £25 million in total, split broadly £20 million for the medium and large employers and £5 million for the small employers. This arises because once initial data has been obtained, calculation is simple, and in most cases can be made at the start of the year and used each year the car remains in use as a company car. This is also an advantage for internal forecasting purposes. However, the new requirement to establish and store the CO₂ level information in a new system is more work with some use of a booklet or web page search, and this is estimated to negate about 20% of the gross saving. The net annual compliance saving is estimated to be about £20 million per year.

Small businesses

22. It is estimated that there are about 140,000 small employers (1 to 4 employees) with at least one company car provided to an employee or director; and about 40,000 employers in the next size category (5 to 9 employees). Overall there are between 900,000 and 1 million active employers in the UK. In broad terms, about a quarter of all small employers (size 1 to 9) provide at least one company car, and so are required to keep information for the P11D for their employees or directors. The one-off compliance cost is likely, on average, to cost a small employer about £30 to £40 in the first year, or some £5 million for all the small employers (1 to 4 employees). However, the net savings in subsequent years are worth about £4 million per year once the new system has bedded in. That is, a small employer would see recurrent costs fall by about £20 to £30 per year principally from the abolition of the requirement to record business mileage for the P11D and maintain verifiable mileage records. The full table of employers with company cars is given below.

Table 1: Number of Employers with company cars by size (number of employees)

Employer size	Number of employers
1 to 4	140,000
5 to 9	40,000
10 to 49	50,000
50 to 99	9,000
100 to 499	8,000
500+ (including Government)	4,000
total	250,000 (rounded)

Other costs/savings

23. *Employees* will no longer be required to keep details of business miles travelled for company car tax purposes. This will relieve them of an onerous burden.

24. *The Inland Revenue* will incur one-off setting up costs such as: making CO₂ data available for cars registered between January 1998 and December 2000; the production of extra guidance for employers; publicity; the revision of the end of year return form for benefits and expenses (the P11D); software changes and staff training. There will also be staff costs in handling queries before, during and after the reform is introduced and in adjusting PAYE codes. Overall, however, setting up costs are expected to be less than £5 million. In the long term, as the system is simpler than the existing one, less customer queries and in-year coding changes might reasonably be anticipated. By removing the business mileage discounts, the new system should be less open to abuse. It is, therefore, reasonable to assume that, over time, compliance enquiries on company cars will be less time-consuming to conduct, directly benefiting the Inland Revenue, and indirectly benefiting employers.

The consultation process

25. An informal consultative process began with the issue of the 1999 Budget Day press release IR4, which invited people to comment on the new regime. Broad

details of the system were then outlined at both Ministerial and official level through a series of articles in the trade press, and in presentations. The Revenue also embarked on a series of meetings with employers and their fleet managers, tax professionals, organisations representing UK car manufacturers, the UK leasing sector, car fleet operators and environmental groups. The decisions on the final shape of the reform reflect those discussions.

Summary

26. The taxation of company cars is to be reformed to help protect the environment. In April 2002, the existing income tax charge will be replaced with a charge based on a percentage of the car's price graduated according to the level of the car's CO₂ emissions. This gives employers and employees a powerful tax incentive to choose more fuel efficient cars. By reducing CO₂ emissions from company cars, the reform will make a significant contribution towards meeting the UK's climate change targets. By abolishing the business mileage discounts, a significant part of the record keeping and reporting requirements inherent in the existing system will disappear. The total first year changeover cost for the affected 250,000 employers is estimated to be about £50 million. But, overall, the reform offers employers a significant saving in compliance costs of about £20 million per year, after the transitional period of changeover.

Enforcement and Sanctions

27. The existing form P11D, used by employers to report benefits in kind, and form P46(car), used to report changes in cars or cars newly provided, will be revised by the Inland Revenue to reflect the new features of the reform. There will, however, be no changes to the existing P11D reporting deadline, or to the sanctions for failing to meet that deadline.

Monitoring And Review

28. Average fleet CO₂ emissions will be monitored on a regular basis to ensure the level of CO₂ emissions qualifying for the minimum charge is appropriate.

Contact point

29. Employers are invited to comment on their savings from the new scheme outside the first year changeover costs. Comments should be sent to:

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