Consultation on modernising tax relief for business expenditure on cars:

summary of responses

October 2007

HM TREASURY

HM TREASURY

Consultation on modernising tax relief for business expenditure on cars:

summary of responses

October 2007

HMSO
Licensing Division
St Clements House
2-16 Colegate
Norwich
NR3 1BQ

Fax: 01603 723000

E-mail: hmsolicensing@cabinet-office.x.gsi.gov.uk

HM Treasury contacts

This document can be found on the Treasury website at:

hm-treasury.gov.uk

For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

ISBN-13: 978-1-84532-349-3

Printed by The Stationery Office 10/07 379441

Printed on at least 75% recycled paper.
When you have finished with it please recycle it again.

PU352

1 Summary of responses

AIM OF REFORM

1.1 Following representations from business that the present rules for the capital allowance treatment of business cars would benefit from reform the Government launched a consultation in Budget 2006. This consultation document sought to develop options that attempted to meet the aims of reducing compliance costs, were consistent with environmental objectives and were consistent with sound public finances and the Government's fiscal rules.

1.2 The possible options for reform were identified as:

- Option 1 – abolish the current rules;
- Option 2 – establish a new car pool, with a lower Writing Down Allowance (WDA) than the general Plant and Machinery pool; or
- Option 3 – Introduce a range of first-year capital allowances (FYAs) based on CO2 emissions with the balance of unrelieved expenditure being taken to a new car pool with lower writing down allowances than the general pool.

Option 3 was seen as meeting all three aims of the reform and was described as the preferred option.

RESPONSES

1.3 There were 23 responses to the Budget 2006 consultation from a range of stakeholders (five professional representatives, ten business representatives, six corporate entities, one individual and one charity). The majority of respondents supported reform of the current system. A quarter of respondents stated a preference for outright abolition of the current system (Option one), with similar numbers proposing alternative options or not stating a preference. Several respondents also indicated that Options two or three would be better than the present system if outright abolition was not possible. With regard to the possible banding structures for different writing down allowances under Option three, the majority of respondents favoured a minimal number of bands, no more than three or four.

REDUCING COMPLIANCE COSTS / SIMPLIFICATION

1.4 On the extent to which the preferred option offered compliance cost savings, there was a fairly even split of views. Just over a quarter of respondents considered that pooling would result in administrative burden reductions, and another quarter considered that even with the introduction of environmental bands, there would still be an overall reduction in administrative burdens.

1.5 However, just under a quarter thought that any savings would be cancelled out by the new requirements imposed by FYA calculations and just under another quarter considered there would be no savings at all, or increased burdens. Savings for small businesses as a result of pooling were likely to be small due to the low volume of vehicles held and the private use adjustment rules. Most small businesses also used external tax advisors, so they would only benefit if those advisors passed on the benefit of a simpler system to their clients.

1.6 If differential banding structures were to be introduced for different rates of FYA, the overwhelming majority of respondents stressed the need to keep the banding structure as simple as possible. Five respondents specified that there should be no more than three or four bands, and four respondents felt there should be alignment with VED or at least no more bands than VED. Two respondents advocated alignment with CCT. It was suggested that the existing 100% FYAs for very low emission cars should be retained.

CONSISTENT WITH ENVIRONMENTAL OBJECTIVES

1.7 In terms of likely influence on behaviour, over half of respondents expressed doubts about how effective an environmentally-based system would be in influencing businesses' purchasing strategies. This is because they felt other factors influence purchasing decisions. Over a third of respondents cited employee choice and the existence of the benefit in kind (BiK) company car tax scheme, and just under a quarter said that car purchase decisions would be driven by the purpose for which the car was required. Three respondents commented that any behavioural impact would also depend on the cost and availability of appropriate vehicles in different bands. The need to ensure that there was a sufficient tax differential was also cited.

1.8 More generally, respondents questioned whether an extra environmental incentive was necessary given the additional administrative requirements that the environmental element would bring to the proposal. Alternative suggestions included:

- strengthening VED or the employee BiK scheme,
- doing more on fuel duty
- considering the wider impact of domestic use
- encouraging, or at least not discouraging, the use of diesel vehicles.

1.9 Some respondents also mentioned the need to consider other factors, such as transport infrastructure, and the environmental impact of the manufacturing process. The need to address the impact of commercial vehicles was also cited with one respondent suggesting environmental incentives for the early adoption of the Euro V emissions standard for trucks.

LEASE RENTAL RESTRICTION

1.10 The consultation document also raised the possibility of reform to the current rules on the Lease Rental Restriction, and in particular the possibility of applying the restriction only to the first or last link in a leasing chain, rather than, as now, to all lessees in a chain.

1.11 The majority of respondents viewed the current permanent disallowance of expenditure on expensive leased cars as causing complexity and said that it should be abolished. Three respondents advocated abolition on a revenue neutral basis, funded by changes to the main system for cars capital allowances. A small minority of respondents advocated compromises such as applying a restriction to the first or last user. Practical issues were also raised about how easy it might be for someone leasing a car to know whereabouts in a leasing chain they might be, particularly if they were leasing from someone who themselves were also leasing the car.

OTHER ISSUES

1.12 *Implications for the self-employed* - Few responses commented on the issue of the self-employed and the private use adjustment. Fifteen responses commented on compliance costs, and four on environmental incentives. On the compliance cost, the majority commented that there would be reduced or no compliance cost benefits for those self-employed car owners subject to private use adjustment rules. A third considered that the current private use rules should be reformed, as maintaining a mileage log was considered burdensome. Two respondents felt that the private use rules should not be changed. Of the responses dealing with incentives, one respondent commented that there would be transitional costs of adapting to the new system. Four respondents commented that the proposed measures would still act as an incentive to buy environmentally efficient vehicles for those subject to the private use adjustment rules, and a further two felt that the measures would be an incentive if car owners were aware of them. Two respondents felt that the proposed measures would not act as a sufficient incentive for behavioural change.

1.13 *Transitional arrangements* - On transitional arrangements, the majority of respondents stressed the need for careful consideration of any reforms, and the need to consult further on more detailed proposals and draft legislation to avoid unintended consequences. The need for careful phasing-in of implementation was also stressed: one respondent suggested a minimum three-month window. Other suggestions included legislation in 2007 followed by implementation in 2008, or legislation in 2008 followed by implementation in 2009. One respondent advocated tying implementation into vehicle registration and the tax year-end. On transitional costs, two respondents commented that there would be costs associated with re-training and IT changes. Two respondents commented on the need to avoid the acceleration of tax payments.

1.14 *Sector specific comments* - there were comments from some stakeholders to the effect that the daily car hire market is distinctive and requires different treatment in the form of an exemption from any regime that would not allow their cars to be included in the general plant and machinery pool.

1.15 There were also concerns raised about the potential impacts on cars which are leased to people with disabilities. These vehicles are exempt from the current rules and it was pointed out that any change could have a direct impact on rental charges as any additional costs would be passed through. There were also comments that special treatment might be needed for taxis.

OTHER SUGGESTIONS

1.16 Other suggestions made were:

- keep the current system but allow all hybrid cars to be included in the general plant and machinery pool, regardless of price,
- capital allowances to follow accounting treatment of depreciation,
- increase the present value threshold to £24,000,
- introduce a first year permanent disallowance based on emissions followed by inclusion in the general pool,
- a surtax on manufacturers,

- a punitive charge paid by sellers on the sale of dirty cars, or
- encourage better servicing to prolong the fuel efficiency of vehicles.

2 CONSULTATION UPDATE

AIM OF REFORM

2.1 The Budget 2007 consultation document repeated the main aims of any reform: that they should centre on reducing compliance costs, be consistent with environmental objectives and consistent with sound public finances and the government's fiscal rules.

2.2 Building on the responses from the March 2006 consultation, the Budget 2007 update consultation presented the following as a refinement of the preferred option:

- Retain the existing 100% FYA for cars with CO2 emissions up to 120g/km;
- Utilise the general plant and machinery capital allowances pool for cars with CO2 emissions between 121 and 165g/km; and
- Introduce a new pool with a lower WDA than that of the general plant and machinery pool, for cars with CO2 emissions above 165g/km.

2.3 It also set out the following as an option for reform of the lease rental restriction:

- abolish the LRR for cars with CO2 emissions below the 165g/km threshold,
- apply a uniform fixed percentage disallowance on relevant rental payments of cars with CO2 emissions above the 165g/km threshold.

RESPONSES

2.4 There were seventeen responses to the consultation update document from a range of stakeholders (two professional representatives, eight business representatives, four corporate entities, one charity and two financial/ business advisors).

2.5 Overall, most respondents who commented on the merits of the refined proposal specifically (seven out of ten) felt that it offered an improvement on the options aired in the previous consultation document and were simpler. One respondent was not opposed to the proposals, but not strongly in favour, one respondent did not welcome the approach and one respondent commented that a better system would be based on actual miles travelled. Some respondents expressed doubt about the extent of the likely additional behavioural effect of environmental incentives. Three respondents stated as their preferred option for all cars to be dealt with in the general plant and machinery pool and one respondent advocated raising the current threshold to £25,000.

REDUCING COMPLIANCE COSTS / SIMPLIFICATION

2.6 There were several constructive comments on possible banding structures in order to minimise compliance burdens and maximise incentives for behavioural change: the majority of respondents favoured minimal bands (no more than three or four), and alignment with VED if possible. Several respondents commented on the need to structure bands and allowance rates in a way that creates significant differentials and provides practical choices between vehicles.

2.7 Three of the eleven respondents who commented specifically on banding considered that the use of fewer WDA bandings and alignment with the VED structure was a sensible approach. Three of them commented that the suggested threshold of 165g/km was too low a point for defining high CO2 emitting cars and that the threshold should be set higher, suggesting 185g/km, 190g/km and 195g/km. Two respondents commented that if the main pool WDA rate was only 20% then there should be no further distinction.

2.8 Two respondents commented that the combination of starkly differentiated WDA pool rates, and few thresholds, would mean that there would be cliff edges and that drivers of cars at the higher end of the scale - within the higher CO2 emitting cars pool - would have difficulties in switching to alternate vehicles below the 165g/km threshold. One respondent commented that for the proposed WDA pools-based system to have a strong influencing effect, a stark differential would be needed between the WDA rates of the different pools.

2.9 Ten respondents made further comments on the simplification/compliance cost aspects of the proposals. One commented that more could be done for firms with large car fleets as the proposals still mean there is a need to track individual cars in order to establish disposal proceeds. One commented that the proposals were a simplification compared to the current system, another believed that the proposals did not present any material compliance savings, another commented that the proposals were simpler than the current system both in terms of purchased cars and leased cars, another commented that for those with large car fleets the proposals were a significant reduction in compliance burdens. Another commented that the proposals represented a reduction in compliance costs and another commented that it would be much simpler for all cars to fall within the general plant and machinery pool.

CONSISTENT WITH ENVIRONMENTAL OBJECTIVES

2.10 Fourteen respondents commented directly on whether they thought the environmental incentives would be effective in influencing purchasing decisions, generally expressing doubt over the extent that they would be successful. Four respondents commented that the purpose for which a car is needed would be the overriding factor in choice of vehicle. Four respondents cited the importance of employee recruitment and retention and allowing employees a choice of vehicle as a factor in purchasing decisions - employees being influenced by the company car tax benefit in kind system, not their employer's capital allowances position. One respondent commented that the tax implications will be seen only by the finance department, and therefore would be unlikely to influence the actual purchaser. One respondent commented that a permanent disallowance would be a more effective influence than the timing differential of capital allowances. One respondent commented that companies would be likely to seek other methods of providing vehicles such as Employee Car Ownership Schemes (ECOS) and cash allowances to avoid the effect of the proposed system. Two respondents commented that in order for there to be an effective influence, changes would be needed to other areas of the system e.g. fuel duty, congestion charging, and graduated vehicle excise duty (VED).

2.11 Two respondents commented that an environmental proposal should be applied to all cars, both business and privately owned. They also commented that the lower WDA pool for higher emitting vehicles could have the effect of encouraging employers to give employees cash allowances to buy vehicles instead. Another commented that the environmental objectives would be unlikely to have a great impact without changes to other parts of the tax system, for example fuel duty and congestion charging. Another commented that the Company Car Tax Benefit in Kind scheme was more likely to have a greater environmental impact. Another respondent called for environmental concerns to be addressed through graduated Vehicle Excise Duty instead, applying to all cars whether business or privately owned.

LEASE RENTAL RESTRICTION

2.12 Noting that the consultation indicated that Government is considering reform of the lease rental restriction, twelve respondents commented on the option of abolishing the current lease rental restriction and introducing a fixed percentage disallowance for all cars over the 165g/km threshold. Eight respondents commented that they remained in favour of outright abolition of any form of restriction on leased cars on the grounds that the first lessor would be subject to the proposed environmental system via the capital allowances rules. One respondent commented that the proposals should remove the current perceived distortion whilst keeping in line with environmental and fiscal objectives.

2.13 Notwithstanding views favouring abolition, four of the respondents welcomed the option of removing the restriction for cars below the 165g/km CO2 threshold, one respondent commented that a realistic disallowance rate would be needed to allow room for business to adjust, two commented that the proposals offered a significant simplification/compliance saving over the existing system, three commented that the restriction should apply to the end user in the chain only and one commented that a deferral rather than a disallowance would be less distortionary.

OTHER ISSUES

2.14 Ten respondents provided comments on the treatment of diesel cars. Nine were in favour of no differential being introduced, and one was in favour of incentivising diesel car usage through removing the 3% Company Car Tax differential and adjusting fuel duty rates.

2.15 Five respondents touched on issues concerned with accounting for private use of business cars/ effects on the self-employed. One commented that the self-employed were likely to see increased compliance costs and little benefit from the proposals given that they hold vehicles for longer periods. Another commented that an emissions-based system similar to the Company Car Tax system with charges for private use could be applied, two others commented that some mechanism would always be needed to identify private use of a business asset and that there would be no way around this - separate asset pools would still be needed. However, one respondent felt the proposals should still apply to the self-employed. Another respondent also commented that little or no compliance savings would be likely where private use was involved due to the need for a private use adjustment, and that the private use adjustment methodology should be reformed. Another respondent called for the Private Use adjustment methodology for cars to be reformed.

TRANSITIONAL ARRANGEMENTS

2.16 Nine respondents commented on transitional issues. Three respondents commented that significant changes to accounting systems would be needed and that costly information gathering exercises would need to be undertaken. Other comments called for:

- implementation to be on a specified date not less than three months after publication of the final proposals,
- businesses to have the option to decide whether or not the new system would apply to their existing cars as well as new cars
- implementation not less than six months after publication of the final proposals
- the system to apply only to transactions undertaken after a specified date
- guidance to be provided as soon as possible if implementation was due to be April 2008
- businesses to have the option to keep existing expensive cars in their separate pools for prior budgeting reasons
- treatment of existing cars to be grandfathered.

2.17 Businesses stressed the need for further consultation on detailed proposals and a careful approach to implementation to allow time for transition and avoid unintended consequences.

SECTOR SPECIFIC ISSUES

2.18 Nine respondents made sector specific points. One commented that the proposals would particularly disadvantage manufacturers with low profit margins. Another commented that if the proposals were to include cars leased to the disabled those people with disabilities could incur increases in rental costs. Another called for the current exemption for daily hire cars to be continued on the grounds that such cars are plant and machinery, and called for leasing companies to be able to make a short life asset election on grounds that their vehicles are sold sooner so pooling them for writing down allowances would not reflect actual depreciation. For the daily hire sector, there were often reasons behind vehicle choices e.g. due to size of tourist parties – the proposals might lead to two cars being hired instead of just one.

2.19 Other respondents called for bio-fuel cars to qualify for 100% FYAs to encourage uptake of such vehicles. Another respondent also called for a short life asset election to be available. Another called for more information on the proposed treatment of currently exempt categories. Another respondent commented that transitional costs would have a greater impact on freelancers and contractors due to lack of administrative resource. Another called for the current exempt categories to be continued, and commented specifically that they considered that there would be little environmental effect and increased compliance costs for SME lessors.

OTHER SUGGESTIONS

2.20 Other comments made included calls for the system to have stability (not changing bands regularly), and for clear review periods, for example three yearly non-retrospective changes as for the Company Car Tax Benefit in Kind system. Other suggestions included two calls for all cars to be included in the general 20% plant and machinery pool, with one of those respondent adding that there should be no disallowance for lease rental expenditure. Another respondent called for an environmental system to be applied to all cars regardless of how they are owned.

ISBN 978-1-84532-349-3

9 781845 323493