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Taxing company cars

In his March 1999 Budget the Chancellor, Gordon Brown, announced a fundamental, revenue neutral, reform of the taxation of company cars, to help protect the environment. This followed a review of the existing regime in the light of the criticism that it encouraged those using company cars to drive extra, unnecessary miles on business. In the March 2000 Budget the Chancellor confirmed that the new system would come into effect from April 2002. This paper discusses the reform and how the new rules are to work in practice.

In addition the paper discusses an associated reform in the 'fixed profit car scheme' – which covers the situation where an employer reimburses an employee for using their own car on business – and recent proposals to amend the tax treatment of free fuel provided by an employer.

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Summary of main points

About 1.67 million directors and employees are provided with a company car for their private use, and of these just over half - some 870,000 people - get free fuel for private motoring.[1] Both of these fringe benefits are taxed as part of someone's remuneration; special rules determine what the cash value of each benefit is for tax purposes.

At present the annual benefit of being given a company car is estimated as 35% of the list price. Deductions from the charge on a company car may be made, depending on the age of the car, whether the employee has made contributions to the employer for the car, and, perhaps most importantly, the annual mileage the employee has covered in using the car for business purposes.

In his March 1999 Budget, the Chancellor Gordon Brown announced a fundamental, revenue neutral, reform of the taxation of company cars, to help to tackle congestion and global warming and improve local air quality.[2] In the March 2000 Budget the Government confirmed that the new system would come into effect from April 2002.[3] A normal minimum charge of 15% of the car's price will apply to cars emitting CO_2 at or below a specified qualifying level – set initially at 165g/km. The percentage charge will build up in 1% steps for every additional full 5g/ km over that level up to a maximum charge of 35% of the car's price. There will no longer be an adjustment for business mileage or for older cars. The qualifying level of CO_2 emissions will gradually be reduced over the first few years of the reform, reflecting anticipated improvements in the fuel efficiency of new cars. Cleaner, alternatively fuelled cars may be entitled to a discount on this tax charge; a supplementary charge will be levied on diesel cars if they do not meet European Community standards for cleaner vehicles.

The Inland Revenue publish a range of material on the taxation of company cars on their internet site,[4] including a leaflet which provides a short overview of the existing rules and the new system.[5]

Although this paper does not discuss vehicle excise duty, it is worth noting that a new system for charging duty – based on carbon dioxide emissions – was introduced on 1 March 2001. All cars registered for the first time are placed into one of four VED bands based on their rates of carbon dioxide emissions. Within each band, there is also a discount rate for cars using cleaner fuels and technology and a small supplement for diesel cars. Details are available from the Driver and Vehicle Licensing Agency.[6]

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1 These figures are for 1999-2000 (*Inland Revenue Statistics 2000* table 4.5).

2 HC Deb 9 March 1999 c 181. Further details were given in Inland Revenue Budget press notice IR4, 9 March 1999.

3 *Budget 2000* HC 346 March 2000 p 118

4 www.inlandrevenue.gov.uk/cars/index.htm

5 *Income tax and company cars IR172*, June 2001

6 www.dvla.gov.uk/newved.htm

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I Taxing company cars: the current rules

Since 1948 the general rule on taxing expenses payments and fringe benefits has been that most – but not all – rank as taxable remuneration.[7] In cases where someone is given a benefit in kind, rather than a cash payment, the cash value of this benefit to that person is added to their taxable income, and taxed accordingly; ie, taxed at the same rate as the rest of their income (22% or 40% depending on their circumstances).[8]

Special rules apply in evaluating the cash value of certain types of benefit: the provision by an employer of a motor vehicle partly or wholly for private use by an employee is the most notable example.[9] The system for taxing company cars was the subject of an important reform under provisions contained in the *Finance Act 1993*, which came into effect on 6 April 1994.[10] In brief, the value to an employee of a company car is now calculated with respect to the car's price, rather than its engine size. The annual benefit of being given a company car is estimated as 35 per cent of the list price. This is subject to an £80,000 ceiling; cars sold in excess of this price are assumed to cost only this figure.[11]

The price of most accessories if attached and available for use with a company car will be included in calculating the car's price.[12] Accessories designed solely for use by the chronically sick or disabled, and accessories which enable those with a disabled person's badge (the "orange badge" – or "blue badge" as is now known) to use the car in spite of the disability entitling them to the badge, are exempt from this calculation – as is equipment to allow the car to run on road fuel gases (such as LPG). In addition the provision of a mobile phone, whether provided with a company car or not, is not treated as a taxable benefit.[13]

Deductions from the charge on a company car may be made, depending on the age of the car, according to whether the employee has made contributions to the employer for the car, and, perhaps most importantly, the annual mileage the employee has covered in using the car for 'business purposes'. Should someone travel over a given number of miles on business in the year, the taxable benefit of the car they drive is reduced: from 35% to 25% of the list price if they travel over 2,500 miles; and to 15% of the list price if they travel 18,000 miles or more.[14] The use of one's company car for 'business purposes' has a

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7 under section 154 of the *Income & Corporation Taxes Act (ICTA) 1988*

8 Benefits in kind are taxed if the person receiving them is a director, or an employee who earns £8,500 or more per year.

9 These rules are contained in section 157 and schedule 6 of *ICTA 1988*.

10 The changes were first announced by the then Chancellor Norman Lamont in his March 1993 Budget speech (HC Deb 16 March 1993 cc 177-178). Further details on this reform are given in *The taxation of company cars*, Library Research paper 93/59, 10 May 1993.

11 under section 168G of *ICTA 1988*

12 Accessories added to the car after it was first made available are included, if they are worth £100 or more.

13 for 1999-2000 and subsequent years, under section 44 of the *Finance Act 1999*

14 Prior to April 1999 these business mileage discounts were larger, the tax charge being cut by 1/3rd for mileage over 2,500 and 2/3 rd for mileage over 18,000 (see pp 15-16 of this paper for more details).

precise definition for tax purposes, meaning travel that the employee is necessarily obliged to do in the performance of their employment.[15] Ordinary commuting – between one's home and place of work – is specifically excluded from this definition.

The tax charge on a company car is triggered by whether the car is *available* to an employee or other members of their family or household for their private use, rather than the degree to which it has been used in practice.[16] In other words, the employee's having a car at their disposal, to use as they might wish, represents the benefit they are being given which is not reflected in their salary – and must be brought into the charge to tax. A car benefit charge would not apply if the terms under which the car is made available by the employer prohibit its private use by the employee, *and* there is no such use in practice.[17]

In relation to age, the tax charge is further reduced by one quarter if the car is over four years old at the end of the tax year.[18] Classic cars over fifteen years old with an open market value of over £15,000 are taxed by reference to their value, if that is higher than their list price.[19] Should the employee have use of a second company car, a mileage allowance is only given on the second vehicle if it is used for at least 18,000 miles a year. Should this be the case, the taxable charge on the second car is cut – from 35% of the list price to 25%.[20]

The charge may be reduced if the car has been unavailable for the use of the employee in excess of 30 *consecutive* days (the charge is reduced proportionately by the fraction of the tax year the benefit has been withdrawn). The charge may be avoided completely where the car provided is a 'pool car', for which the car must satisfy three conditions:

- The car is not used ordinarily by any one employee to the exclusion of others.
- The car is used only incidentally, if at all, for private purposes by any of the employees to whom it is available.
- The car is not normally kept overnight near the home of any of the employees to whom it is available.[21]

Where a car is used by more than one employee without meeting these conditions, all employees permitted to use the car privately would be subject to tax by reference to the car benefit charge. An extra-statutory concession operates in such cases; specifically, ESC A71 which states that "where two or more directors or employees earning £8,500 a year have

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[15] under section 168(5) & 198(b) of *ICTA 1988*

[16] under section 157(1) of *ICTA 1988*

[17] under section 168(6) of *ITCA 1988*

[18] Prior to April 1999 the age discount was 1/3rd. Both the age discount and two mileage discounts were cut under section 47 of the *Finance Act 1999*.

[19] under section 168F of *ICTA 1988*. The £80,000 overall limit also applies to classic cars.

[20] Prior to April 1999 the tax charge on a second car would be cut by 1/3rd for mileage over 18,000.

[21] under para 6-9 of schedule 6, and section 159(1)-(3) of *ITCA 1988*

shared use of a car made available by their employer for private use, only a single scale charge will be made in respect of the car. This will be apportioned between them having regard to all the relevant facts."[22]

The benefit of having private use of a company van - provided the vehicle is no heavier than 3,500 kilograms - is subject to a fixed charge of £500, cut to £350 if the van is over four years old.[23] The provision of parking facilities for an employee at or near his work (including such provision in relation to a privately-owned vehicle) constitutes neither an emolument nor a benefit.[24] That said, the Government has introduced legislation to enable local authorities to levy a new charge – *not* a tax – on non-residential workplace parking.[25]

Some employees may pay a hire charge to their employer, to compensate partly or fully for the cost of their car. In such cases, they will only be assessed on the actual benefit they receive from their employer. The cash equivalent of the benefit is reduced, though not below zero, by any amount paid by the employee which they are required to pay as a condition of the car being made available for private use. This means that employees must show that they would not receive their car without their making these contributions. If they could not, then the Revenue would not be entitled to deduct contributions when assessing the tax due on this benefit. This is why employers often use the formal procedure of a hire charge. On this issue, the *CCH Company Car Tax Guide* states the following:

> Employees are sometimes required by their employers to make a contribution for the use of the car. Such contributions reduce the taxable benefit only if the payment is made 'as a condition of the car being available for his private use', is paid for that use and is paid in respect of the year concerned. A contribution should therefore take the form of a hire charge and should be distinguished from a capital contribution, any reimbursement of the cost of private fuel, or payment for anything else.[26]

As an example, take the case of someone provided with a £15,000 car for 2000-01, which they drove 3,000 miles on business. If they made no contribution to its cost, the Revenue would take the taxable value of this benefit to be £3,750 (ie, 25% of £15,000). In other

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[22] Inland Revenue, *Extra-Statutory Concessions IR1*, January 2000 p 49. An extra-statutory concession is a relaxation which gives taxpayers a reduction in tax liability to which they would not be entitled under the strict letter of the law. Most concessions are made to deal with what are, on the whole, minor or transitory anomalies under the legislation and to meet cases of hardship at the margins of the code where a statutory remedy would be difficult to devise or would run to a length out of proportion to the intrinsic importance of the matter.

[23] under schedule 6A of *ICTA 1988*. Heavier vans are only subject to a tax charge if they are wholly or mainly used for private purposes.

[24] under section 46 of the *Finance Act 1988*

[25] Provisions to introduce workplace parking in London are contained in section 296 and schedule 24 of the *Greater London Authority Act 1999*. Similar provision is made for local authorities outside London under ss 178-190 of the *Transport Act 2000*. For further details see *The Transport Bill: Part III Road charging and workplace parking*, Library Research paper 99/104 13 December 1999 pp 25-34.

[26] Coopers & Lybrand, *The CCH Company Car Tax Guide 1997/1998*, 1997 p 22

words, it is assumed that the employer decides to give someone this benefit, instead of an additional £3,750 added to their salary. This is why this sum is taxed at an individual's marginal rate of income tax. If the hire charge was, say, £1,800 a year, the taxable benefit would be £1,950.

At first sight, the fact that someone pays a hire charge, but still pays a tax charge for the supply of this car, may seem unfair. Even so, one must remember that the tax charge is assessed only on the *net* benefit that person enjoys. If one wished to compare the tax position of two people being given the same remuneration, then one would have to assume that the employee who made no contribution to the cost of their car received £1,800 less in the form of cash each year. Many would argue that it is only fair to tax those who receive the same remuneration - irrespective of its composition in terms of cash or non-cash benefits - in the same fashion.

Finally it is worth noting that the provision of a company car, as well as free fuel, is subject to employers National Insurance contributions (NICs). Class 1A contributions were introduced by the *Social Security (Contributions) Act 1991* with effect from 6 April 1991 with the purpose, in the words of the then Minister for Social Security Nicholas Scott, "to fill … an important gap in the national insurance contributions system as a result of which employers do not pay contributions to the national insurance fund if they pay their employees in cars rather than in cash."[27] Class 1A contributions were extended to most other benefits in kind from 6 April 2000.[28]

The cost of this tax relief, as well as the number of employees provided with company cars, was discussed in a written answer in March 1996 – part of which is reproduced below; for convenience figures for the last five years are also given:

> The cost of tax relief on business cars is to a large extent offset by the tax yield on the private use of such cars. Detailed estimates of the overall number of business cars are not available but the estimated cost in 1995-96 of capital allowances claimed on all business cars, including those purchased by unincorporated businesses, is £2.2 billion. This compares with an offsetting yield from the taxation of the private use for employees of £1.4 billion. Estimates of the cost of relief are not produced on a regular basis.
>
> The table gives estimates of the numbers of employees who are provided by their employers with cars which are available for private use. There are also currently about 1.8 million self-employed people who claim relief for business cars against Schedule D income tax liability. Figures for other business cars - taxis, pool cars, drive hire cars etc. - are not available.

27 HC Deb 9 May 1991 c 849

28 For details see, *The Social Security Contributions (Share Options) Bill*, Library Research paper 01/07, 22 January 2001 pp 11-12.

Numbers with taxable car benefit (thousands)

1980-81[1]	560
1981-82[1]	650
1982-83[1]	790
1983-84[1]	850
1985-86	1,070
1987-88	1,550
1988-89	1,750
1989-90	1,850
1990-91	1,950
1991-92	1,900
1992-93	1,810
1993-94	1,740
1994-95	1,700
1995-96	1,650
1996-97	1,650
1997-98	1,710
1998-99	1,680
1999-00	1,670[29]

[1] Figures exclude married women

II Proposals to reform the taxation of company cars

Since its introduction in April 1994 the current system for taxing company cars has been strongly criticised, particularly in relation to the way in which the tax charge is mitigated for those drivers who use their cars most. Indeed evidence from the National Traffic Survey in 1999 suggests that drivers covered an extra 300 million additional *business* miles a year, to take advantage of the mileage discounts.[30] More detailed estimates of the annual mileage of company cars were given in two written answers in April & June 1999, reproduced below:

> **Mr. Baker:** To ask the Chancellor of the Exchequer how many company cars travelled *(a)* more and *(b)* less than 18,500 miles in the last year for which figures are available.
>
> **Ms Hewitt***:* Annual mileage data are collected only for drivers whose company cars are available for private use. According to the latest National Travel Survey,

[29] sources: HC Deb 26 March 1996 cc 577-578W; *Inland Revenue Statistics 1998* p 57; *Inland Revenue Statistics 2000* p 62. Regular statistics on the number of employees in the UK taxed on the private use of a company car were not collected by the Revenue before 1978-79 (HC Deb 25 February 1993 cc 701-2W). The number of cars in that year were 550,000. These figures are reproduced in Library Research paper 93/59 pp 13-15.

[30] SC Deb (B) 25 May 1999 c 398

> there were an estimated 925,000 company car drivers whose total mileage was at least 18,500 miles per annum. This compares to 675,000 company car drivers whose total annual mileage was less than 18,500 miles per annum.[31]
>
> **Mr. Baker:** To ask the Chancellor of the Exchequer, pursuant to his answer of 26 April 1999, *Official Report*, column *55*, how many company cars travelled (i) less than 10,000, (ii) between 10,000 and 13,000, (iii) between 13,001 and 16,000, (iv) between 16,001 and 18,500, (v) between 18,501 and 19,000, (vi) between 19,001 and 20,000, (vii) between 20,001 and 23,000, (viii) between 23,001 and 30,000 and (ix) more than 30,000 miles in the last year for which figures are available.
>
> **Ms Hewitt:** The only available information on the total mileage of company cars is the National Travel Survey, but this does not have a large enough sample size to provide the detail requested. The available estimates, which cover company cars available for private use, are shown in the table.

Total annual mileage	*Number of company cars*
Less than 10,000	175,000
10,000 to 13,999	250,000
14,000 to 18,499	250,000
18,500 to 29,999	475,000
30,000 or more	450,000[32]

It should be noted this figure was for *total* mileage – business and private mileage combined. Some estimates distinguishing between business and private travel were given by the then Economic Secretary, Patricia Hewitt, at the Committee stage of the *Finance Bill* in May 1999. On this occasion the Minister stated that it was estimated that around 1.15 million drivers drove less that 18,000 business miles and 500,000 drove more than 18,000 business miles. Overall, company car drivers tended to do the same amount of private mileage in a year – around 11,000 miles a year.[33]

In autumn 1995 the lobby group Transport 2000 published the results of a study on company cars which argued the current system was distortionary, inefficient, and seriously damaging to the environment. The report argued that the system encouraged drivers to drive more, and fabricate their tax returns, to reduce the amount of tax they paid on this benefit:

> Drivers are actually rewarded with higher tax breaks the more they drive on business. This encourages company car users not only to drive more than they need, but to falsely declare their mileage, thereby depriving the Exchequer of revenue. The Inland Revenue currently requires no evidence on tax returns that claimed business mileage is actually undertaken. These fundamental weaknesses,

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31 HC Deb 26 April 1999 c 55W

32 HC Deb 29 June 1999 c 142W

33 SC Deb (B) 25 May 1999 cc 397-399

> together with other breaks still available to employers who buy or lease the cars, keep in place a culture of car use which runs directly counter to Government aims to reduce car dependency, air pollution and pressure for building developments on green field sites.[34]

In January 1997 during Treasury Questions Michael Jack, then Financial Secretary to the Treasury, confirmed that Transport 2000 had lobbied the Government on this issue - "questioning whether unnecessary business mileage was in sum being increased to achieve tax breaks" - but went on to say, "no evidence of such usage could be found. There is anecdotal evidence, but overall I do not believe that there is widespread abuse."[35]

Some evidence on this question was published in June 1997 by the Ashden Trust, an environmental lobby group, working with London First and the University of Westminster's Transport Studies Group. Drawing on a number of surveys of drivers and fleet managers, the report concluded that, "the current tax discounts awarded to company car drivers reaching defined business mileage thresholds lead to some distortion of declared business mileage, possibly increasing this by around 5% … about 60% of this distortion arises from additional business mileage being driven (adding about 1 billion miles)." Overall the authors recommended that business mileage discounts be replaced "by a tax which relates to the number of private miles driven" so that the "personal 'perk' value of the company car to the driver [would be] directly reflected in the amount he/she pays, and that the "fuel consumption figure (ie, the mpg) of the car be applied as a factor to the list price" in determining the value of the taxable benefit.[36]

A number of other criticisms about the incentives the tax system created were made in an article by the motoring correspondent of the *Independent* at this time:

> Britain's company car culture ... has done Britain's car makers - and this country's car buyers - a great disservice. It exacerbates traffic congestion, has stifled our industry's creativity, and has artificially inflated prices for private buyers ... The main reason why British retail car prices have usually been higher than on the Continent is because of the subsidies given to company buyers. Our car industry has also atrophied under the burden of trying to please the fleet buyer. Big fleet buyers are different from private or small company buyers. As a rule, they have been after lots of posh kit in as big a car as possible. That's why British cars that have been popular here ... and all British-assembled Japanese-badged cars ... have typically been flops on the Continent ...
>
> Those who rely on cars for their jobs should be encouraged to buy and use their own cars. Their employers would then pay them a mileage rate, as typically happens on the Continent. Just watch the standard of driving improve, as some of

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[34] Transport 2000, *Company Cars*, October 1995 p 3

[35] HC Deb 16 January 1997 c 449

[36] Ashden Trust, *Company car taxation: a contribution to the debate*, June 1997 pp 6-9

> these company-car kamikazes start to use their own vehicles! They, too, would inevitably buy smaller and more frugal cars.[37]

The Labour Party's transport strategy document published in May 1996 raised the possibility of amending the tax treatment of company cars: "the structure of company car taxation should be reviewed to encourage more energy efficient and environmentally sustainable car use. We fully recognise however that for many jobs the provision of a car or other motor vehicle is essential."[38] Despite speculation to the contrary,[39] no changes were made in the Labour Government's first Budget following the general election in July 1997, although a number of tax measures to help the environment were introduced: for example, the Government increased the 'road fuel escalator' – the commitment to increase excise duties on road fuel in real terms by 5% per year, set in the November 1993 Budget – to 6%.[40]

In addition, the Government gave a wider statement of intent on the use of green taxes:

> The Government's central economic objectives are the promotion of high and sustainable levels of growth and high levels of employment. By that we mean that growth must be both stable and environmentally sustainable. Quality of growth matters; not just quantity. Delivering sustainable growth is a task that falls across government. It will be a core feature of economic policy under this administration. The Treasury is committed to that goal.
>
> How and what governments tax sends clear signals about the economic activities they believe should be encouraged or discouraged, and the values they wish to entrench in society. Just as work should be encouraged through the tax system, environmental pollution should be discouraged. To that end, the Government will explore the scope for using the tax system to deliver environmental objectives - as one instrument, in combination with others like regulation and voluntary action.
>
> Over time, the Government will aim to reform the tax system to increase incentives to reduce environmental damage. That will shift the burden of tax from "goods" to "bads"; encourage innovation in meeting higher environmental standards; and deliver a more dynamic economy and a cleaner environment, to the benefit of everyone. But environmental taxation must meet the general tests of good taxation. It must be well designed, to meet objectives without undesirable side-effects; it must keep dead-weight compliance costs to a minimum; distributional impact must be acceptable; and care must be had to implications for international competitiveness. Where environmental taxes meet these tests, the Government will use them.[41]

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[37] "Why Blair should smash the company car", *Independent*, 26 April 1996

[38] Labour Party, *Consensus for Change*, May 1996 p 14

[39] "Budget car tax will backfire", *Times*, 28 June 1997

[40] In the March 2000 Budget the Chancellor Gordon Brown confirmed that the escalator would be withdrawn, and that duty rates would be increased in line with inflation; for details see *Road fuel prices and taxation*, Library Research paper 01/52, 11 May 2001.

[41] HM Treasury press notice, *Tax measures to help the environment*, 2 July 1997

The following year the Chancellor, Gordon Brown, announced a review of the structure of company car taxation, specifically to "consider … the case for replacing the existing business mileage discounts with discounts for driving fewer private miles in company cars."[42] The review was mentioned in the Government's White Paper on transport, published in July 1998:

> We recognise that some drivers have to use a car because of the nature of their work. However, the existing system for taxing company cars has been criticised as providing a perverse incentive to drive further in order to reach the business mileage thresholds which attract significant reductions in the tax liability. In the March 1998 Budget, the Chancellor announced that he would be considering the case for replacing the existing business mileage discounts with discounts for driving fewer private miles in company cars, and invited people to send comments to the Inland Revenue. So far, a wide range of organisations and individuals have responded.[43]

Some details of the comments received by the Revenue were given in the *Pre-Budget Report* in November 1998:

> Many of those who commented supported the proposal, as business mileage discounts were seen as an incentive to drive unnecessary, extra miles. Others were neutral or opposed to the change suggested. A concern about giving discounts for low private mileage is that it would simply shift private miles from company cars to private cars, which would not help reduce congestion or pollution. It would also mean extra record-keeping for company car drivers and their employers. In light of the views expressed, the Government is continuing to review how the company car tax regime might be altered to send better environmental signals.[44]

In the March 1999 Budget it was announced that the existing income tax charge based on 35% of the car's price – subject to business mileage and age-related discounts – would be abolished, and replaced by a charge on a percentage of the car's price graduated according to the level of the car's carbon dioxide emissions.[45] As mentioned above, both the business mileage discounts and age-related discount were cut at this time, under provisions in the *Finance Act 1999*. When these provisions were debated at the Committee stage of the *Finance Bill*, the then Economic Secretary, Patricia Hewitt, made a number of comments about the current system:

> The existing discounts for business mileage have been widely and persistently criticised for sending adverse environmental signals ... We estimate on good evidence that 300 million additional business miles are being driven in response

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[42] Inland Revenue Budget press notice IR6, 17 March 1998
[43] Cm 3950 pp 122-123
[44] *Pre-Budget Report* Cm 4076 November 1998 p 81
[45] Inland Revenue Budget press notice IR4, 9 March 1999

> to the perverse incentives … created by … the present system of company car taxation. Those extra business miles produce extra carbon dioxide, pollution and congestion. Discounts also encourage the misdeclaration of private miles as business miles, which leads to further tax leakage.
>
> For those reasons, we propose to replace the current system of discounts for business miles with a completely new system based on the emissions produced by the car. We are consulting on the specific issue of whether the new charge should be levied simply on the basis of emission of CO_2 - the main greenhouse gas - or whether we should consider other emissions as well. If we take account of other emissions or provide a discount for cars running on diesel, that will complicate the system further. That is why we are consulting …
>
> The new system will tax all company car drivers on the benefits that they derive from having the car available for private use … The policy is part of our declared intention of modernising the tax system on the basis of environmental principles. Taxation must be shifted to reflect properly the environmental costs of what is being enjoyed. In this case, what we are taxing properly - and what was not properly taxed under the previous Government's system -is the availability of a company car for private use. Whether the company car is a perk, or whether it is provided because the individual has to drive extensive mileage in the course of his work, they all tend to do the same amount of private mileage -approximately 11,000 miles a year. That benefit will be charged to tax in a way that reflects the environmental cost of the benefit, because the list price will be discounted according to the emissions of the car …
>
> Before the changes proposed in the clause, a two thirds discount on the taxable benefit from the list price was given when 18,000 or more business miles were driven. That was an effective charge on 11.67 per cent. of the price of the car. We propose to increase that to 15 per cent. A one third discount was given when between 2,500 and 18,000 business miles were driven. That was an effective charge of 23.33 per cent., which is now being increased to 25 per cent. No changes are proposed for those driving fewer than 2,500 business miles, who will continue to be taxed on the full charge of 35 per cent. of the car's price … The net result of the clause is to reduce slightly the incentive to drive unnecessary extra business miles. That will help, in a modest way, to ease urban congestion, reduce pollution and, above all, pave the way for radical reform in 2002.[46]

[46] SC Deb (B) 25 May 1999 cc 398-400

III The new system from April 2002

In the March 2000 Budget the Chancellor, Gordon Brown, confirmed that the Government would proceed with the changes in company car taxation announced the year before.[47] Details were given in a press notice issued at the time:

> From 6 April 2002, the Government will:
>
> - base the tax charge on a percentage of the car's price graduated according to the level of the car's carbon dioxide (CO_2) emissions. The charge will build up from 15 per cent of the car's price, for cars emitting 165 grams per kilometre (g/km) CO_2, in 1 per cent steps for every additional 5g/km over 165g/km. The maximum charge will be on 35 per cent of the car's price;
>
> - abolish existing business mileage discounts when the new system starts. These have, unintentionally, provided tax incentives to drive more business miles in order to get bigger discounts and have been responsible for up to 300 million extra miles being driven each year. Their abolition will help to reduce pollution and congestion. Age-related discounts, which provide an incentive to keep older, more polluting cars, will be abolished at the same time; and
>
> - subject diesel cars to a 3 per cent supplement in recognition of their higher emissions of pollutants that damage local air quality. This will not take the maximum charge above the current maximum of 35 per cent of the car's price.
>
> Following further consultation, details will be announced of a waiver for very low emission diesel cars and discounts for other environmentally friendly cars, such as those that run on electricity or a combination of petrol and gas or electricity (which could reduce the charge below the usual minimum of 15 per cent of the car's price) … For the longer term, the Inland Revenue will be considering how the authorised mileage rates for drivers who use their own cars for business journeys might be improved, on a revenue neutral basis, to send better environmental signals.

This press notice went on to explain how the tax charge would operate in practice:

> The starting point for calculating the tax payable remains the car's price. The charge will be based on a percentage of that price graduated according to the car's carbon dioxide (CO_2) emissions measured in grams per kilometre (g/km). The exact CO_2 figure will be rounded down to the nearest 5g/km for company car tax purposes. Cars emitting CO_2 at or below a specified level will be taxed on 15 per cent of the car's price (the usual minimum charge). This qualifying level of CO_2 emissions will gradually be reduced over the first few years of the reform,

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[47] HC Deb 21 March 2000 c 868

reflecting anticipated improvements in the fuel efficiency of new cars. The level of CO_2 emissions qualifying for the minimum charge will be as follows:

- 2002-03 165g/km CO_2
- 2003-04 155g/km CO_2
- 2004-05 145g/km CO_2

The table [below] shows how cars will be taxed in the first three years of the reform. A car emitting 168g/km CO_2 when first registered, for example, will be charged to tax on 15 per cent of the car's price in 2002-03, 17 per cent in 2003-04 and 19 per cent in 2004-05 …

CO_2 EMISSIONS IN GRAMS PER KILOMETRE			**% OF CAR'S PRICE TAXED**
2002/03	**2003/04**	**2004/05**	
165	155	145	15*
170	160	150	16*
175	165	155	17*
180	170	160	18*
185	175	165	19*
190	180	170	20*
195	185	175	21*
200	190	180	22*
205	195	185	23*
210	200	190	24*
215	205	195	25*
220	210	200	26*
225	215	205	27*
230	220	210	28*
235	225	215	29*
240	230	220	30*
245	235	225	31*
250	240	230	32*
255	245	235	33#
260	250	240	34~
265	255	245	35†

Diesel Supplements
* add 3 per cent if car runs solely on diesel
# add 2 per cent if car runs solely on diesel
~ add 1 per cent if car runs solely on diesel
† maximum charge so no diesel supplement[48]

Legislation to introduce the new system for taxing company cars was included in the *Finance Act 2000*.[49] It is estimated that, after behavioural changes, this reform will be

[48] Inland Revenue Budget press notice REV6, 21 March

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. However, these estimates are uncertain, particularly because of uncertainty about the scale of anticipated changes in behaviour.[50]

Information on the CO_2 emissions figures for particular makes and models of car is provided on the internet site of the Society of Motor Manufacturers and Traders (SMMT), by agreement with the Revenue. Individuals, taxpayers and employers can access that database on a car by car enquiry basis – for all cars first registered from January 1998 to 28 February 2001.[51] Indicative CO_2 emissions figures for all *new* car models is available on the Vehicle Certification Agency site.[52]

At the time of the March 2001 Budget the Government confirmed it would introduce regulations to waive the diesel supplement "for clean diesel cars achieving Euro IV emission standards to encourage their early introduction", and to "introduce discounts for cars powered by electricity or gas, and hybrid petrol/electric cars which can reduce the car benefit tax below the normal minimum of 15 per cent of the car's price, providing further incentives to choose more environmentally friendly company cars." It went on to note that, "this comprehensive change to the company car tax system is estimated to save around 0.5 to 1.0 MtC [million tonnes of carbon] per year by 2011-12. It is regarded as crucial in shaping the future car fleet of the UK given that over 50 per cent of new cars are bought by companies."[53]

Under the new system, the taxable benefit of a company car with a list price of, say, £18,000 with CO_2 emissions of 205 gms/km, would be assessed as:

- 2002-03 23% of list price = £4,140
- 2003-04 25% of list price = £4,500
- 2004-05 27% of list price = £4,860

If the individual concerned was a 40% taxpayer, then the tax charge would be:

- 2002-03 £1,656
- 2003-04 £1,800
- 2004-05 £1,944

By comparison, the tax charge on a car of this price under the current system, if driven over 18,000 miles a year on business by a 40% taxpayer, is £1,080. Of course if the

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49 specifically section 59 and schedule 11 of the *Finance Act 2000.* These provisions were the subject of a short debate at the Committee stage of the *Finance Bill 2000* (SC Deb (H) 25 May 2000 cc 419-423).

50 *Income tax and company cars: environmental and regulatory impact assessment*, March 2000 para 9

51 www.smmt.co.uk. Single enquiries are free of charge. For multiple enquiries and those who require the whole database SMMT will make a charge. Details of costs are shown in the 'Fleet Contact Form' which can be accessed from the introduction page for the CO_2 database on the SMMT's website.

52 www.vca.gov.uk. The approved CO_2 emissions figure for cars registered on 1 March 2001 or after are to be shown on the Vehicle Registration Document (V5).

53 *Budget 2001* HC 279 March 2001 p 114. These regulations – SI 2001/1123 – were laid on 22 March 2001.

mileage discount is ignored – say if someone only travelled under 2,500 miles on business – the tax charge on this benefit under the current system would be £2,520: that is, (35% x £18,000 = £6,300) x 40%. If a car of this price had a much lower emission level, - say 155 gms/km – the tax charge, all other things being equal, under the new system would be £1,080 for 2002-03.[54]

This example highlights two aspects of this reform: first, abolishing the current mileage discounts substantially changes the way the tax system encourages driving; second, introducing discounts based on CO_2 emissions creates significant incentives: for employers to give their employees more environmentally friendly cars as part of their remuneration; and for motor manufacturers, to improve emission standards for all classes of vehicle, even executive models.

Clearly for drivers there is an incentive to change the type of company car they are given. One tax practitioner writing on the new system noted, "inevitably there are some winners and some losers. The abolition of the business mileage discounts means that those undertaking high levels of business mileage are likely to be hardest hit, particularly if they drive an expensive car with relatively high CO_2 emissions."[55] Indeed, one might argue that a reform in company car taxation that did not encourage a change in behaviour on the part of drivers, employers and manufacturers, would not be successful. A survey carried out by the Institute of Directors in summer 2001 concluded that "the Government's policies seem to be working, especially amongst larger companies, with a swing away from company cars and changes in fleet compositions."[56]

The Financial Secretary, Paul Boateng, set out the Government's assessment of the new scheme in two written answers reproduced below:

> **Miss McIntosh:** To ask the Chancellor of the Exchequer what recent representations he has received on the taxation of company cars; and what recent assessment he has made of the impact of taxation on company car use.
>
> **Mr. Boateng:** The new CO_2 emissions-based system of company car tax comes into effect from April 2002. It has been the subject of extensive consultation since proposals were first announced in Budget 1999. The Inland Revenue has received few recent representations. The new system will provide an incentive to use cleaner cars. Extensive evaluation is planned through analysis of Inland Revenue data and by surveys of employers and employees.[57]

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[54] For example, the Audi A6 Avant TDI has an emissions level of 157 gms/km ("You could be driven to think", *Financial Times*, 29 March 2000). As noted, further details of how the new rules work are published on the Inland Revenue's site (www.inlandrevenue.gov.uk/cars/index.htm).

[55] "Which way now?", *Tax Adviser*, June 2000

[56] Institute of Directors press notice, *SMEs response to the new company car tax regime*, 28 August 2001

[57] HC Deb 26 June 2001 cc 59-60W

> **Miss McIntosh:** To ask the Chancellor of the Exchequer, pursuant to his answer of 26 June 2001, Official Report, column 59W, on company cars, what assessment he has made of the impact of the loss to employees of company car tax concessions.
>
> **Mr. Boateng:** The new company car tax system from April 2002 is designed to achieve lower levels of harmful emissions from cars. It does away with the reductions for driving higher levels of business mileage as this can be an incentive to drive unnecessary business miles. The reforms have been projected to have a broadly neutral effect on tax revenues, so in overall terms there is no loss to employees. Many company car drivers will be paying less tax for the benefit of their company car under the new system. Having a company car with relatively low carbon dioxide emissions would help to ameliorate tax liabilities under the new system for any driver. It is worth noting that we expect more drivers to take the opportunity of having a company car under the new rules. In fact the Inland Revenue has estimated that the reforms will lead to a net increase of around 200,000 company cars in the long term.[58]

A regulatory impact assessment published in March 2000 summarised the changes that it is expected the new system will have:

> 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 CO_2 emissions. This gives employers and employees a powerful tax incentive to choose more fuel efficient cars. By reducing CO_2 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.[59]

In June 2001 the Revenue requested employers to submit information on their provision of company cars, so that PAYE tax codes for 2002-03, to be issued in January 2002, could reflect any changes in tax liability as a consequence of the new rules.[60] In particular, employers were asked for a list of employees expected to retain their company car after the start of the new tax year, their car's level of CO_2 emissions and the type of fuel used.[61] To date it appears that relatively few employers have done this. In addition the Revenue has conceded it has had computer problems in setting up the new system,

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[58] HC Deb 4 July 2001 c 171W

[59] *Income tax and company cars: environmental and regulatory impact assessment*, March 2000 para 26

[60] *Car benefits: employers June mailshot*, June 2001 This is reprinted on the Revenue's site at: www.inlandrevenue.gov.uk/pdfs/emp2001/cocar_mshot.pdf

[61] For cars registered between 1 January 1998 and 5 April 2001. Employers were asked to submit details of the car's engine size, for cars registered before 1 January 1998.

and that considerable numbers of employees may have received the wrong tax code.[62] It has advised individuals to check their tax code, and in case of errors, alert their payroll department or local tax office. The following guidance was published recently:

> From April there is a new system for calculating the value of the benefit of having a company car. The charge will be based on the car's carbon dioxide (CO_2) emissions and the existing reductions for business mileage and older cars will no longer apply. Because in most cases, we don't have all the information we need to calculate the value of the benefit using the new rules the amounts of car benefit in recently issued PAYE Coding Notices for 2002-2003 are based on estimates and probably need to be changed. Where the amount of benefit we have estimated is too low that could mean that company car drivers will underpay tax through the year and will face an unexpected tax bill later on.
>
> Where we have had to estimate the amount of car benefit, company car drivers should have received a leaflet with their Coding Notice explaining this and asking them to send us the information we need to ensure that they pay the right amount of tax through the year. In many cases this did not happen. We apologise for that. Another leaflet will be issued to those drivers at the end of February/ beginning of March telling them exactly what information we need from them and how they can give it to us. We would encourage everyone who receives one of those leaflets to contact us with the details we need to put in place the correct tax code before the beginning of the new tax year on 6 April. They will then pay the right amount of tax through the year on their company car benefit.
>
> In other cases where the correct information has already been provided to us by employers the recently issued Coding Notices have not been calculated as they should have been because of a problem with the transfer of information between our computer systems. (Since 6 April 2001, employers have been required to provide us with CO_2 emissions details where a car is changed or first made available after that date. In addition, some employers have provided us with information for cars made available before that date). Again, we apologise for this. Revised Coding Notices using the information already given to us will start going out to company car drivers within the next few weeks and everyone concerned should have received one by the end of March. This will ensure that these people too pay the right amount of tax through the year on their company car benefit.[63]

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[62] "Row over company car tax mistakes", *Financial Times*, 28 January 2002, "Taxman's blunder hits company cars", *Times*, 26 January 2002

[63] Inland Revenue, *Calculation of company car benefits for 2002-03*, January 2002 at: www.inlandrevenue.gov.uk/cars/calc_ben_company_cars.htm.

IV The fixed profit car scheme & mileage allowances

Some employees use their *own* car for business, and are reimbursed for this cost by their employer. In this situation, the Revenue operates an administrative arrangement known as the fixed profit car scheme (FPCS): a voluntary system which means employers and employees do not need to keep detailed records of these costs. The scheme establishes a set of mileage allowances, which are estimates of the average cost of running a car per mile, given the size of the car's engine.[64] Lower estimates cover any business miles travelled in excess of 4,000 a year. The estimates are based on a proportion of the routine costs (such as depreciation, servicing, insurance and road tax) and all the running costs (such as fuel) attributable to the business miles travelled. Any allowance paid by an employer for an employee's expenses in excess of the cost calculated under the FPCS will be counted as a taxable benefit.[65]

It is important to note that the scheme only covers the use of one's car for business travel. In brief, these are journeys which:

- employees *have to make* in the course of doing their job. For example, if an employee travels from their office to visit a client and uses their own car, they can get tax relief for their motoring costs, to the extent that their employer does not meet them, or
- employees make to or from a place they *have to attend* in order to do their job. For example, if an employee travels directly from home to visit a client, that is business travel, for which they can get tax relief (unless the journey is practically the same as their ordinary commuting journey, because the client's premises are just down the road from their office).

Two types of journey are not covered by the scheme:

- ordinary commuting – that is, travel between one's home and any other place one attends for personal reasons (such as the home of a friend or relative) and one's usual workplace;
- private travel, that is any other travel where the purpose is not for business.

Employees do not need to be in a FPCS to use these authorised mileage rates. Any employee who uses his or her own car for business travel is able to use the Inland Revenue car mileage rates to calculate any taxable profit on car allowances and motor mileage allowances received. In addition, employees may also use the rates to support a tax deduction for business motoring expenses, whether or not they are paid car or mileage

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[64] This scheme is separate to the system of fuel scale charges, which deals with an employer's provision of free fuel for use by an employee in a company car for private motoring. This is examined in section V of this paper.

[65] For details see, Inland Revenue, *Using your own car or motorbike for work IR125*, October 2000.

allowances by their employer. If the total car and motor mileage allowances paid are more than the sum calculated using the Inland Revenue car mileage rates then the employee is taxed on the difference. If they are less, then the employee can use the rates to calculate the allowable business motoring expenses. But the allowances actually received from the employer must be taken into account when calculating the tax deduction for allowable motoring expenses.

The authorised mileage rates for 2000-01 are given below;[66] the rates are unchanged since 1997-98:[67]

	Authorised rate per mile	
Size of car engine	***On the first 4,000 miles in the tax year***	***On each mile over 4,000 miles in the tax year***
up to 1,000 cc	**28p**	**17p**
1,001cc - 1,500cc	**35p**	**20p**
1,501cc - 2,000cc	**45p**	**25p**
over 2,000cc	**63p**	**36p**

As part of the reform in this system of allowances – discussed in detail below – the two lower bands (for cars up to 1,500 cc) have been increased to 40p (for the first 4,000 miles) and 25p (for mileage in excess of 4,000) for 2001-02. The upper bands remain unchanged.[68]

The Inland Revenue estimate that 3 million people use their private car for business. Of these, 2.3 million receive some compensation from their employers for business mileage. Nearly 80% of them drive fewer than 4,000 business miles per year, whilst only 5% drive more than 12,000 miles.[69]

Finally employees are not *required* to use the authorised mileage rates in determining the proportion – if any – of the expenses they receive for using their own vehicle which is a taxable profit. Should they wish, they can keep records of the actual costs they incurred in using their vehicle for business, and make a claim under the statutory rules for determining chargeable profit on this type of expense payment.[70] In one respect calculating the allowable deductions they may make will be quite complex: the proportion of the vehicle's value that can be said to have depreciated over the tax year.

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66 Inland Revenue press notice, 14 December 1999

67 *Tolley's Income Tax 2001-02* para 75.43

68 Inland Revenue Budget Note BN2, *New statutory mileage rates*, 7 March 2001. For motorcycles the mileage rate is set at 24p per mile.

69 *Authorised mileage rates: regulatory impact assessment*, April 2001 para 20

70 The statutory rules for mileage allowances are set out in ss 197B-F of *ICTA 1988*.

A word on the tax treatment of depreciation. Capital allowances provide taxpayers – companies or individuals – with a method to write off the costs of depreciation against taxable profits. Under the current system allowances are available for certain classes of asset only, such as industrial buildings and structures, agricultural buildings and machinery & plant.[71] There is general provision for employees and office holders who have to provide machinery & plant for use in their duties to claim allowances against tax,[72] and specific provisions concerning a vehicle used partly for business travel.[73] In practice employees usually adopt the simpler method of using the FPCS, rather than having their entitlement to capital allowances assessed on the statutory basis.

A package of measures to encourage green commuting was announced in the March 1999 Budget, which introduced a new mileage allowance for an employee's use of a bicycle for business – set at 12p per mile – and a new relief for employer-provided bus travel. A press notice issued at the time gave details, from which the following is taken:

> From 6 April 1999, there will be no tax charge on the following green commuting benefits provided by employers:
>
> (i) works buses with a seating capacity of 17 or more which are used to bring employees to and from work
>
> (ii) general subsidies to public bus services used by employees to travel to work, provided the employees pay the same fare as other members of the public
>
> (iii) bicycles and cycling safety equipment made available for employees to get between home and work
>
> (iv) workplace parking for bicycles (and motorcycles).
>
> In addition –
>
> (v) employees who use their own bicycles for business travel will be able to claim capital allowances on a proportion of the cost of the bicycle.
>
> (vi) An authorised tax free mileage rate of 12p per mile for business cycling will apply. So employers can pay up to 12p per mile to their employees tax free for using their own cycles on business travel; and employees will be able to claim tax relief on 12p per business mile if their employer provides no payment (or be able to claim relief on the balance up to 12p per mile if the employer pays less than this rate).

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[71] Most expenditure on machinery & plant qualifies for an allowance of 25% per year on a reducing balance basis.

[72] This provision was made under section 27(2) of the *Capital Allowances Act (CAA) 1990*, and is consolidated in section 36 of the *Capital Allowances Act (CAA) 2001*.

[73] This was made under section 27(2A)-2E of *CAA 1990*, consolidated in section 80 of *CAA 2001*.

> (vii) An existing Extra Statutory Concession (ESC A66) will be extended … to help employers promote car sharing arrangements by their employees. This will allow employers to pay tax free for alternative transport to get car sharers home when exceptional circumstances, such as a domestic emergency, mean that the normal car sharing arrangements unavoidably breakdown … [74]

Following discussion of these provisions at the Committee stage of the *Finance Bill*,[75] the Government introduced a number of changes at the Report stage to relax and clarify these exemptions, the most important of which was to reduce the works bus seating requirement from 17 to 12.[76]

On the specific matter of extending capital allowances to an employee's provision of a bicycle for business use, an extract from the *Finance Bill 1999* Notes on Clauses may be helpful:

> Where an employee uses his own cycle to travel in the performance of the duties of his employment, there is at present no relief for the proportion of the capital cost of the bicycle attributable to the business journeys. [Clause 47 of the Bill – now section 50 of the *Finance Act 1999*] will introduce relief for the capital cost along the same lines as applies to other machinery owned by an employee and used in the performance of the duties of an employment. Capital allowances will generally be due by reference to the proportion of the capital cost which the business cycling bears to the total cycling mileage in the year.

Turning back to the issue of authorised mileage rates and the FPCS, at the time of the March 2000 Budget it was announced that the Inland Revenue would review the operation of these mileage rates; details of this review were given in a written answer in June 2000:

> **Mr. Rammell:** To ask the Chancellor of the Exchequer (1) if he will authorise a review of the Inland Revenue's fixed profit car scheme rates which were last reviewed in 1997, with special reference to petrol prices for motorists; (2) if he will place in the Library details of the methodology used by the Inland Revenue in calculating the motor mileage rates used in the fixed profit car scheme.
>
> **Mr. Timms:** Under the current system, authorised mileage rates are calculated by reference to typical tax allowable motoring costs for cars with different engine sizes. The costs include both running costs (petrol, oil, tyres, repairs,

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[74] Inland Revenue Budget press notice IR5, 9 March 1999

[75] SC Deb (B) 25 May 1999 cc 403-425

[76] HC Deb 6 July 1999 cc 867-875. In addition the test for whether a bicycle provided by an employer would be tax-exempt was made less onerous; tax relief is given if the bike is mainly used for the commuting journey. The legislation is contained in ss 48-50 of the *Finance Act 1999*.

> replacements and servicing) and standing costs (VED, insurance, depreciation and subscriptions).
>
> The Budget Day 2000 press release REV6 - 'Protecting the environment: reform of company car taxation' announced a review of the authorised mileage rates system which is now under way. The announcement stated that: "The Inland Revenue will be considering how the authorised mileage rates for drivers who use their own cars for business journeys (which underpin the Inland Revenue's fixed profit car scheme) might be improved, on a revenue neutral basis, to send better environmental signals." The level and structure of the authorised mileage rates will be considered in the course of the review. Comments are welcome and should be sent by 30 September 2000 ...[77]

In the November 2000 *Pre-Budget Report* some details of the Government's plans to restructure mileage allowances were given:

> To complement these reforms to company car taxation, the Government intends to restructure the administrative system of authorised mileage rates. This two stage reform will cost the Exchequer £45 million per year by 2002-03. **To provide an early incentive to use cleaner cars for business trips, drivers of small cars will benefit from an increase in the current two lower bands to 40 pence for the first 4,000 miles and 25 pence for further miles from April 2001. The rates for the two higher bands will be frozen.**
>
> For the second stage of reform, the Government will be consulting with interested parties on the introduction of a new statutory system of mileage rates from April 2002. The proposed statutory system will provide a greater incentive to drive cleaner vehicles for business trips by offering:
>
> - **a single, tax and NICs free, rate of 40 pence per mile for the first 10,000 business miles per year for all sizes of car; and**
> - **a single lower rate of 25 pence per mile for any additional business miles above the first 10,000.** [78]

At this time the Government also announced a number of measures to be introduced in the March 2001 Budget, following the provisions to encourage green commuting in the 1999 Budget:

> Budget 99 introduced a package of measures to promote green travel plans. The Government will build on these reforms in Budget 2001 by :
>
> - removing VAT from the purchase of cycle helmets with effect from 1 April 2001 to encourage road safety and encourage cycle use;

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[77] HC Deb 29 June 2000 c 591W

[78] *Pre-Budget Report* Cm 4917 November 2000 p 130

- increasing the income tax and NICs free mileage rate employers can pay for cycle use for business trips to 20 pence per mile from April 2002;
- introducing a new passenger rate of 2 pence per mile per passenger to encourage car-sharing on business trips in private cars from April 2002; and
- lowering the threshold for works buses qualifying for tax exemptions from 12 passenger seats to nine from April 2002 to assist and encourage employers in smaller companies to set up Travel Plans to help their employees to travel to work without using their cars.[79]

In the March 2001 Budget the Government confirmed it would proceed with this two stage reform in authorised mileage rates, and these wider changes in the tax treatment of travelling expenses. The structure for the new system of 'approved mileage allowance payments' (AMAPs) from 2002-2003 will be as follows:

> **Rates for 2002-2003**
> The tax and NICs free rates, which will apply from 6 April 2002, are as follows:
>
> | | |
> |---|---|
> | Cars and vans | |
> | On the first 10,000 miles in the tax year | 40p per mile |
> | On each additional mile over 10,000 miles | 25p per mile |
> | | |
> | Motor cycles | 24p per mile |
> | Bicycles | 20p per mile |
>
> If employers pay less than the statutory rate, employees may claim tax relief up to that level. But employees will no longer be able to make a claim for tax relief based on actual receipted bills, nor claim capital allowances or interest on loans related to car purchases. The existence of the new statutory rates will not prevent employers paying higher rates if they choose to do so, but any amount paid in excess of the statutory rates will be liable to tax and NICs.
>
> **Passengers**
> Employers will be able, if they wish, to pay up to 5p per mile free of tax and NICs for each passenger carried. The passenger must be a fellow employee making the same business trip. This measure applies only where employers pay extra for carrying passengers. Where there are no payments for carrying business passengers, employees will not be able to claim any tax relief.

Further details were given in two Revenue Budget Notes published at the time.[80]

On 2 April 2001 the Government published an environmental and regulatory impact assessment of the introduction of AMAPs; the document provided a breakdown of the numbers of owner-drivers, and their annual level of business mileage:

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[79] *ibid.*
[80] Inland Revenue Budget Notes BN 1 & 2, 7 March 2001

Distribution Of Private Cars Used For Business By Annual Business Mileage
in thousands

Level Of Annual Business Mileage	Cars Up To 1500cc	Cars Between 1500cc And 2000cc	Cars Over 2000cc
0 – 1,999	830	880	80
2,000 – 3,999	230	320	30
4,000 – 7,499	140	190	20
7,500 – 9,999	30	60	20
Over 10,000	40	130	40
Total	1,270	1,580	190

It went on to comment on the proportion of these drivers who would gain or lose from the new system:

> ***Gainers/Losers:*** the theoretical numbers are evenly split, with around 1.56 million potential gainers and 1.48 million potential losers from the measure. The amounts of tax and NICs gains and losses are mostly small, as the majority of employees drive less than 4,000 business miles per year. The numbers of potential gainers and losers represent estimates on the basis that all business mileage is paid at the current and future authorised rates. In practice, DETR-commissioned research suggests that only around one-third of private sector employers (covering around 16% of private sector employees who can reclaim business mileage) and 4% of public sector employers who reimburse employees using their own vehicles for business travel pay at the current authorised rates. However the research suggests that much larger proportions are influenced by the authorised rates in setting their rates.[81]

The document also examined what the impact of the new system might be on driver behaviour:

> ***Behavioural Effects*** – the restructuring of rates may induce some drivers, particularly those for whom business use of their car is a major percentage of its usage, to downsize to smaller cars. We estimate only around 75,000 drivers, mainly with cars of 2,000cc or above, will face significant downsizing incentives. There is no *direct* incentive under the proposed AMAP changes to induce individuals to reduce their business mileage in the same way that there is under the new company car tax regime where business mileage discounts are being abolished. There is also no incentive to downsize by *explicitly* being more generous to cars under 2000 cc and less generous to those over 2000 cc in terms of reimbursement. However running costs per mile will often be relatively higher

[81] *Authorised mileage rates: regulatory impact assessment*, April 2001 para 14

> for larger cars than smaller cars and the new AMAPs regime will not make any allowance for this. There is therefore a limited incentive to downsize.
>
> The regime is expected to lead to some changes in business mileage driven – with those getting more reimbursement under the new rules possibly choosing to drive more frequently, those getting less reimbursement possibly cutting back their business mileage. In both cases this can only happen where business travel is flexible.
>
> We believe the net effect on CO_2 emissions is likely to be modest, with expected savings in CO_2 carbon emissions estimated at around 2,000 tonnes per year after full adjustment. This is due to a combination of some reduction in business miles being driven and some downsizing of cars. This compares with a lower range estimate of 500,000 tonnes per year in CO_2 carbon savings arising from the company car tax reforms after full adjustment.
>
> But the AMAP changes are expected to lead to some reduction in the previously forecast level of net cashing-in under the new emissions-based company car taxation regime to be introduced in 2002-03. We previously estimated a net cashing-in of approximately 180,000 company cars after full adjustment, which would be reduced to approximately 150,000 after full adjustment under the new AMAPs regime to be introduced in 2002-03 (But these estimates are subject to fairly wide margins of error). This could reduce the environmental impact if many drivers move into larger, older, less fuel efficient cars rather than company cars.[82]

Clearly the new statutory system for mileage allowances – just as the FPCS – is intended to compensate drivers for *all* relevant costs incurred in using their vehicle for business travel, including depreciation costs. Under the old system drivers had to choose between the two routes for making a claim: either the FPCS, or using the statutory rules set out in ss 197B-F of *ICTA 1988* and section 80 of the *Capital Allowances Act 2001*. As a consequence of the new system, employees are not to be allowed to make an *additional* claim for depreciation costs under the capital allowances legislation. Legislation was contained in the *Finance Act 2001* to introduce the new rules (specifically ss 57 & 59 and Schedule 12 of the Act).[83]

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[82] *op.cit.* paras 15-18

[83] These provisions were the subject of a short debate at the Committee stage of the *Finance Bill* on 1 May 2001 (SC Deb (a) cc 70-79).

V Taxing free fuel

Many company car users are also provided with free petrol for their private motoring. The cash equivalent of this benefit is fixed by reference to three bands of engine size. The charge is apportioned if a company car is available for part of a year only, and is reduced to nil if the employee makes good the cost of all the fuel he or she has used for private journeys.[84]

As part of the package of measures to rebalance taxes imposed on road vehicles introduced in the March 1998 Budget, it was announced that the tax charge on the benefit of free fuel would be increased by 20 per cent over and above the usual increases in line with pump prices for the next five years. Initially the scale charges on diesel fuel would be increased by more than this margin to align them with the charges for petrol.[85]

Details were given in a press notice issued at the time:

> To reduce the impact on the environment of emissions from company cars, the Chancellor proposes in his Budget:
>
> - to increase the scale charges for petrol provided for private motoring in company cars by 20 per cent over and above the usual increases in line with pump prices including fuel duty in 1998-99 and in each of the following four years 1999-2000 to 2002-03;
> - to increase further in 1998-99 the scale charges for diesel provided for private motoring in company cars to align them with those for petrol cars of the same engine capacity;
> - to disregard the extra cost of enabling company cars to run on cleaner and greener road fuel gases when calculating the income tax charge on company cars from 6 April 1999; and
> - to consider alongside the proposals in the forthcoming Integrated Transport White Paper the case for replacing the existing business mileage discounts with discounts for driving fewer private miles in company cars.
>
> The Chancellor's intention is to discourage employers from providing and employees from accepting free fuel so that more company car drivers face the full cost of the fuel they use for private motoring. This should result in fewer private miles being driven and lower carbon dioxide emissions. The higher increase for diesel charges should help reduce urban pollution in the form of particulates and nitrogen oxides …

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[84] As mentioned above, using one's car to travel between home and work is generally regarded as a private journey, not a business one, since this expense is not incurred in the performance of one's employment.

[85] HC Deb 17 March 1998 cc 1109-1110

Gas-powered cars : Where a company car is converted to run on road fuel gases - compressed natural gas (CNG) or liquid petroleum gas (LPG) - the cost of conversion will be ignored in calculating the taxable benefit for 1999-2000 and subsequent years of assessment: in other words, the conversion cost will not be treated as an accessory in determining the price of the company car for tax purposes.

Similarly, where a company car is designed to run on road fuel gases from new, so much of its price as is solely attributable to equipment necessary to allow the car to run on CNG or LPG will be ignored for tax purposes for 1999-2000 and subsequent years of assessment: in effect the tax charge will be based on the price of the equivalent petrol or diesel model.[86]

Legislation to amend the scale charges for free fuel for 1998-99, and to exempt conversion costs for gas-powered cars, was introduced under ss 59-60 of the *Finance Act 1998*.[87] The scale charges for free fuel for 1997-98 – prior to this reform – and for the current tax year, 2001-02, are shown below:[88]

PETROL CARS

Engine size cc	***Scale charge £***	
	1997-98	***2001-02***
0 – 1,400	**800**	**1,930**
1,400 – 2,000	**1,010**	**2,460**
2,001 +	**1,490**	**3,620**

DIESEL CARS

Engine size cc	***Scale charge £***	
	1997-98	***2001-02***
0 – 2,000	**740**	**2,460**
2,001 +	**940**	**3,620**

A survey of responses to the changes in company car taxation carried out by the Institute of Directors reported many respondents as saying “they will change or review their policy on private fuel.”[89]

In the November 2001 *Pre-Budget Report* the Government announced that it would “shortly invite views on proposals to restructure the fuel scale charge for 2003 to relate it to carbon dioxide emissions.”[90] The Revenue issued a consultation document in

86 Inland Revenue Budget press notice IR6, 17 March 1998

87 In the case of the latter the Government accepted an amendment to implement this change from April 1998, rather than the following year as initially proposed (SC Deb (E) 21 May 1998 cc 399-400).

88 The scale charge for cars without a cylinder capacity was £1,490 for 1997-98 and is £3,620 for 2001-02.

89 Institute of Directors press notice, *SMEs response to the new company car tax regime*, 28 August 2001

90 Cm 5318 November 2001 p 128

December 2001, setting out three options for a new fuel scale charge, and asking for views on their respective advantages from an environmental and administrative point of view. A short extract is reproduced below:

> This tax year is the fourth of a five-year programme of annual increases in the income tax fuel scale charge announced in Budget 1998 to discourage the giving or receiving of free fuel for private use in a company car. Following this programme of increases the Government is considering restructuring the charge from April 2003 to one based on exhaust emissions to make it more environmentally friendly. **The government wants a new system that would both help the environment and be easy for employers to implement and employees to understand …**
>
> The Government has identified three possible options for restructuring the fuel scale charge to make it more environmentally friendly, in particular to better reflect the CO_2 and other environmental pollution produced by different cars. The possible structures, all related primarily to CO_2 emissions, follow the pattern of the new company car tax and car vehicle excise duty.
>
> **Option 1**
> To link the free fuel benefit charge directly to the level of the CO_2 emissions of the car. The CO_2 emissions figure for the car, rounded down to the nearest 5 grams per kilometre (g/km) in line with the new company car tax, would be multiplied by a set amount to determine the free fuel benefit charge for the car. To promote the movement to cleaner cars a lower multiplier could be set for cars with lower CO_2 emissions. A possible refinement would be a lower multiplier for low emission cars below 185g/km in line with lower Vehicle Excise Duty charges.
>
> For example, for a Ford Mondeo 1.8 Zetec with CO_2 emissions of 185g/km (rounded down) the fuel scale charge would be calculated by multiplying 185 by a fixed amount (185 * £X = fuel scale charge).
>
> **Option 2**
> To link the charge directly to the percentage figure used to calculate the car benefit charge. In this case, the percentage figure depends on the level of CO_2 emissions of the car and also takes account of supplements for diesels and discounts for alternative fuels. The percentages for petrol and diesel range from a minimum of 15 to a maximum of 35 per cent. The percentage for alternative fuels and hybrid cars can be below 15 per cent with discounts. Under the company car tax system the percentage figure is multiplied by the list price of the car to arrive at the tax charge. Under this option, the free fuel charge would use the same percentage figure and multiply it by some fixed amount to determine the free fuel benefit charge.
>
> For example, a Ford Mondeo 1.8 Zetec with CO_2 emissions of 185g/km (rounded down) would have a company car tax percentage for 2003/04 of 21%. The fuel scale charge for 2003/04 would be calculated by multiplying the car tax rate 21% by a fixed amount (21 * £Y = fuel scale charge).

Option 3
The free fuel benefit charge would be structured in the same way as the Vehicle Excise duty system. There would be four bands of CO_2 emissions – up to 150, 151 to 165, 166 to 185 and over 185g/km. The amount of fuel charge would vary according to whether the car runs on alternative fuel, petrol or diesel as well as the appropriate band for the CO_2 emissions of the car.

For example, a Ford Mondeo (petrol) 1.8 Zetec with CO_2 emissions of 185g/km (rounded down) would fall into the third band and the fuel scale charge would be the appropriate amount for a petrol car.[91]

The deadline for comments is 8 February 2002.

[91] Inland Revenue, *Consultation on possible structures for a more environmentally friendly free fuel scale charge where employers provide free fuel for private use in a company car*, 6 December 2001

VI Further reading

A. HM Treasury & Inland Revenue

Inland Revenue Budget press notice IR4, *Improving the environment: major changes to the taxation of company cars*, 9 March 1999
http://www.nds.coi.gov.uk/coi/coipress.nsf/1da827e79df1aaf98025673500583789/e9c30e8f145b65ac80256737003463f1?OpenDocument

Inland Revenue Budget press notice REV6, *Protecting the environment: reform of company car taxation*, 21 March 2000
http://www.hm-treasury.gov.uk/Budget/Budget_2000/Press_Notices/bud_bud00_pressrev6.cfm

Income tax and company cars: a major reform: environmental and regulatory impact assessment, March 2000
http://www.inlandrevenue.gov.uk/ria/ria_environ.pdf

Using your own car or motorbike for work IR125, October 2000
www.inlandrevenue.gov.uk/pdfs/ir125.pdf

Inland Revenue Budget Note BN1, *Works buses*, 7 March 2001
http://www.inlandrevenue.gov.uk/budget2001/revbn01.htm

Inland Revenue Budget Note BN2, *New statutory mileage rates*, 7 March 2001
http://www.inlandrevenue.gov.uk/budget2001/revbn02.htm

Inland Revenue Budget Note BN3, *Changes in fuel scale charges*, 7 March 2001
http://www.inlandrevenue.gov.uk/budget2001/revbn03.htm

Authorised mileage rates: regulatory impact assessment, April 2001
http://www.inlandrevenue.gov.uk/ria/ria_amr.pdf

Income tax and company cars IR172, June 2001
http://www.inlandrevenue.gov.uk/pdfs/emp2001/ir172.pdf

Consultation on possible structures for a more environmentally friendly free fuel scale charge, December 2001
http://www.inlandrevenue.gov.uk/consult_new/fuel_scale_charge.pdf

B. Other sources

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"Company cars: what are the new rules?" & "The winners and losers – what should they do?", *The Tax Journal*, 25 September 2000

"Gas guzzlers made to pay", *Times*, 10 March 2001

"Hello John, got a new tax demand?", *Financial Times*, 21 March 2001

"Company car tax hits gas-guzzlers", *Sunday Times*, 19 August 2001

"Company cars", *The Tax Journal*, 12 November 2001

"How to make most of car tax change", *Sunday Times*, 9 December 2001

"Cut tax with a greener company car", *Sunday Times*, 27 January 2002

"Row over company car tax mistakes", *Financial Times*, 28 January 2002

"Taxman's blunder hits company cars", *Times*, 26 January 2002