EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (CONSIDERATION FOR FUEL PROVIDED FOR PRIVATE USE) ORDER 2007

2007 No. 966

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 This measure changes the way in which the flat rate basis for calculating VAT on fuel provided for private use is operated. The flat rates are contained in a table and were previously applied by reference to a vehicle's engine size (cc) and fuel type. This measure introduces a new table, supplemented by Notes, which is applied by reference to a vehicle's CO_2 emissions figure. Where a vehicle does not have a CO_2 emissions figure the Notes to the table apply a CO_2 emissions figure by reference to the vehicle's engine size.

2.2 The flat rates have been calculated in line with the average cost of fuel applicable in March 2007.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 Section 57 of the Value Added Tax Act 1994 contains a table, Table A, which provides for the application of flat rates by reference to the engine size and fuel type of a vehicle. Section 57(4) provides that a new table may, by order of the Treasury, be substituted for Table A. New tables have been substituted annually to increase the rates in line with changes to the average cost of fuel.

3.2 Section 2 of the Finance (No. 2) Act 2005 amended section 57 by adding new subsections which extend the power to substitute the Table to permit a table which describes a vehicle by reference to its CO_2 emissions figure, the type or types of fuel or power by which it is propelled, the engine size or any combination of these descriptions. The extended power also permits the table to be implemented by rules or supplemented by Notes. Section 2 was brought into force by an appointed day order made pursuant to section 2(7) of the Finance (No.2) Act 2005 (S.I. 2007/946(C.38)).

3.3 This measure, pursuant to the new powers in section 57, substitutes a new table for Table A which applies flat rates to vehicles based on their CO_2 emissions. The table is supplemented by Notes which provide for vehicles which do not have a CO_2 emissions figure by applying a CO_2 emissions figure by reference to the vehicle's engine size. The Notes also make provision for the rounding down of a certificated emissions figure to the nearest multiple of 5 and for vehicles which have 2 competing CO2 emissions figures.

4. Legislative Background

The UK has a derogation (Council Decision 659/2006/EC) from the EC Sixth Council Directive (77/388/EEC). The derogation authorises the UK to fix, on a flat rate basis, the proportion of value added tax relating to expenditure on fuel used for private purposes in business cars. The rates are to be established on the basis of the CO_2 emissions level of the type of vehicle and reflect fuel consumption. The amounts of the flat rates are to be adjusted annually to reflect changes in the average cost of fuel. This measure gives effect to the derogation.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, Mr John Healey M.P., has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Consideration for Fuel Provided for Private Use) Order 2006 are compatible with the Convention rights.

7. Policy background

7.1 VAT is payable if a business provides road fuel that is used, not for the purposes of the business, but for private motoring. Table A in section 57 applies to calculate what figure represents the tax inclusive value of the supply. The flat rates contained in the table were previously applied by reference to a vehicle's engine size (cc) and fuel type.

7.2 The change in the basis of the VAT fuel scale charge from engine size and fuel type to CO_2 emissions aligns the basis of the VAT private use charge with that operated for direct tax purposes. It is also in line with the Government's wider environmental policy objectives. The annual revalorisation amends the value of the existing fuel scale charge to reflect any change in the fuel price. This adjustment is necessary for the UK to satisfy the terms of the derogation.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum

9. Contact

David Webb at Her Majesty's Revenue and Customs Tel: 020 7147 0641 or e mail: david.webb@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

Full Regulatory Impact Assessment

Submitted by H M Treasury

30 November 2006

Title of Proposal

Value Added Tax (Cars) (Determination of Consideration for Road Fuel Supplied for Private Use) Order 2007

Purpose and intended effect

Policy Objective

The proposed measure will change the basis of the existing Value Added Tax (VAT) private use charge from engine size to CO_2 emissions and so will align the VAT private use charge with that for direct tax. The CO_2 based system is also designed to raise the environmental profile and encourage businesses to switch to cars with lower emissions.

Background

As a general rule VAT is deductible only in so far as it relates to the taxable business activities of a taxpayer. In the case of fuel, the business use of each car would need to be determined in order that the right amount of value added tax is deducted. This would involve taxpayers in maintaining full mileage records for each car. By way of voluntary simplification the UK provides taxpayers with an average private fuel expenditure charge for each car, thereby removing the administrative burden of full mileage records. The existing legislation is in Value Added Tax Act 1994 section 57 and policy for this legislation is administered by HMRC.

Rationale for Government Intervention

The measure will introduce a new VAT fuel scale charge, which will follow a carbon emissions basis, as part of the Government's strategic approach to vehicle tax working alongside the reformed company car tax and fuel benefit charge. Legislation has been enacted in the Finance (NO. 2) Act 2005 which provides that the new

system will be brought into force on a day or days as the Treasury may appoint by order.

Consultation

Within Government

HMRC consulted with direct tax colleagues, Treasury and Department of Environment Food and Rural Affairs on the environmental aspects.

Public consultation

In advance of the legislation, HMRC sent a discussion paper to fourteen trade and professional bodies and advisers. In general terms, there was not much enthusiasm for the proposal. Several respondents expressed concerns about its effectiveness as an environmental measure; the incremental cost for a higher polluting vehicle was not significant as the charge must be linked to the cost of fuel and such a low differential would never affect the choice of vehicle. Similarly, several respondents thought the implementation costs could be significant where IT system changes were necessary although follow up consultation efforts have suggested that IT costs might not be as significant as first thought. However, there was an acceptance about the worthiness of a joined up environmental message and the consistency of having a VAT scale charge that, like direct tax and Vehicle Excise Duty, adopted a CO_2 basis.

Option for Achieving Policy Objective

HMRC wished to raise the environmental profile and provide a consistent message on the issue of CO_2 emissions. These benefits could not have been achieved if the VAT fuel scale charge had remained unchanged. Having undertaken to make the change, we offered the respondents to our earlier discussion a range of options. The options were based on variants of the model adopted for company car fuel benefit charge purposes, which has 21 bands and CO_2 increments of 5g/km ranging from 140-240 or above. The variants can be summarised as follows:

- Same range with increments of either 15g/km or 45g/km
- Extended range with same increments
- Extended range with 15g/km, 30g/km or 55g/km increments.

Consultees accepted that the extended range would better target the lower and higher polluters. However, it would introduce a further system different to others already in place for company car fuel benefit, which has 21 bands and Vehicle Excise Duty, which has 6 bands. Therefore, the final preference was for a scheme based on

the current company car fuel benefit tax scheme. This was on the basis that business is more familiar with this scheme and would find the changeover to a similar one for VAT purposes less of a burden.

Costs and Benefits

Sectors and groups affected

Any business that currently uses the existing VAT fuel scale charges system will be affected by the proposed measure. The measure does not impact on any one sector because the simplified system is available to all UK businesses and should be no more or less likely to be used by any particular sector or business owning cars. Furthermore, the fuel scale charge system is entirely voluntary. With regard to business groups, one of the respondents to the last round of consultation indicated that in their opinion not many large employers would use the VAT fuel scale charge system because of the cost inefficiencies of the benefit in kind rules. So it would appear that the proposed measure would impact more on small and medium enterprises.

Costs

This proposal should have a nil impact on businesses' administrative burdens, as measured by the Standard Cost Methodology. It will not lead to businesses having to submit any additional information to HMRC, nor should it add to the net level of complexity when completing existing information obligations. Instead, all costs of this proposal will be wider compliance costs that do not form part of the Standard Cost Methodology.

Business compliance costs are expected to be largely 'one-off' costs of introducing the new scheme. There was a general consensus amongst those consulted that ongoing compliance costs would be negligible. Once the new system becomes embedded, it should be no more complicated to operate than the existing system; businesses will still have to identify their vehicle on a table of vehicle characteristics, just as before.

Although the table will have more bands than at present, 21 possible charges compared to 6, it should be no harder to identify where vehicles fit on that table. Furthermore, the new system will have one less dimension to it in that the fuel scale charge will be determined by CO_2 emissions alone rather than a combination of fuel type and engine capacity. The exception will be for vehicles too old to have an official CO_2 rating; these businesses will be assigned a set band in the new system based on engine capacity alone, as with direct tax company car charges. However, the number of these older vehicles being used by businesses will decline over time, and so this issue will also continue to fade as time goes by.

Those who responded to our discussion paper indicated that the effect on a small business with few cars would be insignificant on an individual trader basis. Any one-off cost to smaller businesses should mostly be caused by having to familiarise themselves with the proposed CO_2 based system. (Many businesses will already be aware of the underlying concept from using the company car fuel benefit.) For businesses unaware of their CO_2 rating, a number of publicly available websites provide details on vehicles' official CO_2 emission levels, and so the cost per business of searching for this information will be minimal.
Vehicle Certification Agency - CO2 Database [1]

Larger businesses operating large fleets of cars which still use the fuel scale charge system will incur some costs in adapting their IT systems to reflect the new system. However, meetings with those trade bodies involved in the discussion process concluded that these changes might be relatively easy to complete.

Having considered all of the above factors HMRC have estimated the total additional one-off compliance cost for the new measure to be around £4 million. HMRC also estimates that the total number of businesses affected is approximately 540,000. The estimated one-off cost per business is therefore low; around £7.50 per business on average, although there will be a distribution of businesses above and below this average figure depending on the circumstances of individual businesses.

[1] http://www.vcacarfueldata.org.uk/search/search.asp

Benefits

The measure will reinforce the Government's strategic approach to vehicle tax working alongside the reformed company car tax and fuel benefit charge. As such, it will contribute to the Government's goal of delivering a better environment and provide consistent tax incentives for less polluting cars.

There may be a small benefit to businesses through having Vehicle Excise Duty, direct tax company car charges and VAT fuel scale charges all using a common basis. However, some respondents to our discussion paper indicated that these efficiency savings might be negligible. In the interests of caution, we have therefore chosen to discount any such possible benefit from our analysis of this proposal.

This proposal is designed to be revenue neutral overall.

Small Firms Impact

As mentioned above, informal consultation indicated that there does not appear to be any significant impact on small business at the individual level. The Federation of Small Businesses has been involved at every stage of the consultation process and has not raised any concerns. Other respondents specifically made the point that the impact on small businesses would not be significant.

Competition Assessment

This proposal has been run through the Cabinet Office's competition assessment filter test. As the proposal simply changes the basis of the existing VAT fuel scale charge, it is not expected to have any additional effects on competition.

Enforcement, Sanctions and Monitoring

The private use charge is a well-established system by which taxpayers can account for privately used fuel. In addition, under the existing system, the charge is revalorised each year to reflect changes in fuel prices; taxpayers are therefore used to annual changes in the amount of the charge. Consequently, we do not foresee any enforcement problems by simply changing the basis of the charge.

Clear guidance and information on the new arrangements will be published to minimise the potential for accidental errors when introducing the new system.

Since the level of the fuel scale charge will need to be kept in line with fuel prices, the effects of the new system will be monitored as part of that annual process.

Implementation and Delivery Plan

We are publicising the changes to the fuel scale charge system in December 2006, which is well in advance of the 1 May 2007 implementation date. The advance publicity will give larger businesses sufficient time to make any necessary IT changes and will include a specimen of the new legislation as well as details of the link to the Vehicle Certification Agency website should businesses not have details of their vehicles CO_2 rating. There is no need for additional guidance as those businesses which already use the existing VAT fuel scale charge will be familiar with the system and there are no new forms relating to the change.

Post Implementation Review

We will carry out a post implementation review after 2 years of the changes coming in to force.

Summary & Recommendation

After extensive consultation with business we have recommended the 21 band CO_2 system as detailed in the **Option for Achieving Policy Objective** section above. This option will achieve the policy objectives of raising the environmental profile of company cars and providing a consistent message on the issue of CO_2 emissions.

John Healey MP

Financial Secretary to the Treasury

Her Majesty's Treasury

REGULATORY IMPACT ASSESSMENT

Value Added Tax (Cars) (Determination of Consideration for Road Fuel Supplied for Private Use) Order 2007

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

John Healey
ECONOMIC SECTRETARY TO THE TREASURY
5th December 2006