Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	**Impact Assessment of reforms to the Vehicle Excise Duty rules on refunds and six month licences**	
Stage: Implementation	**Version:** 1.0	**Date: 22 April 2009**

Related Publications: Budget 2008, Pre-Budget Report 2008 –(VED administration and collection is not the responsibility of HMRC but of DVLA. Tax policy is, however, determined by the Treasury and this IA is therefore provided alongside other tax IAs on the HMRC website)

Available to view or download at:

http://www.hmrc.gov.uk/better-regulation/ia.htm

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What is the problem under consideration? Why is government intervention necessary?

First-year rates (FYRs) of vehicle excise duty (VED) will be introduced in 2010. They are intended to act as a strong signal at the point of purchase that motorists can save money by buying a lower-carbon version of a new car within their preferred class. FYRs will apply on the first vehicle licence for a brand new car. For higher-carbon cars, FYRs will be higher than the standard rate of VED charged on all subsequent licences. Without reforms to the VED rules on refunds and six month licences, owners of higher-carbon new cars would be able to pay less than the full amount of FYR. This would reduce the incentive to buy a lower-carbon car, and weaken the environmental signal that FYRs are intended to send.

What are the policy objectives and the intended effects?

Reforms are needed to prevent owners of higher-carbon new cars being able to pay less than the full amount of FYR by taking a refund or a six month licence on the first vehicle licence. Reform to these rules will mean that the expected environmental savings from encouraging the purchase of lower-carbon cars will be protected. These savings are estimated to lead to a 0.9 million tonne reduction in carbon dioxide (CO_2) by 2020.

What policy options have been considered? Please justify any preferred option.

1) Do nothing.

2) Limit VED refunds on the first vehicle licence up to the standard rate for new cars in VED Bands H to M in certain circumstances.

3) Disallow refunds on the first vehicle licence for new cars in Bands H to M in certain circumstances.

4) Disallow six month licences on the first vehicle licence for new cars in Bands H to M.

Options 2 and 4 are preferred, as they are felt to be the best balance between protecting environmental savings and maintaining the provision of benefits to vehicle owners.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? A post implementation review will be carried out around three years after the changes are introduced in April 2010.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:

Date: 20/3/09

Summary: Analysis & Evidence

Policy Option: 2 and 4	**Description: Limit VED refunds to the standard rate on the first licence in certain circumstances and disallow six month licences on the first licence for vehicles in VED Bands H to M**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	One-off familiarisation costs for affected businesses, as well as staff training and systems changes at the Driver and Vehicle Licensing Agency. There is likely to be an increase in compliance costs for businesses submitting more VED refunds for higher-carbon cars. Estimates exclude DVLA costs.
£ Up to 300k		
Average Annual Cost (excluding one-off)		
£ Approx £250-500k		**Total Cost** (NPV) **~ £2½-5m over 10 yrs**

Other **key non-monetised costs** by 'main affected groups'

Businesses unable to take out six month VED licences on higher-carbon new cars may experience decreased cash flow as a result of having to take out a 12 month licence instead. They will have to decide how to respond to the changes and whether or not to consult advisers.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Measures protect environmental signal of VED first-year rates, ensuring forecast carbon savings are delivered. Average annual benefit is based on estimated first-year rate carbon savings over the period 2010-11 to 2020-21, converted to 2009 £s.
£ N/A		
Average Annual Benefit (excluding one-off)		
£ Up to £1.75m		**Total Benefit** (NPV) **Up to £15m over 10 yrs**

Other **key non-monetised benefits** by 'main affected groups'

Measures will also protect tax revenue by removing opportunities to pay less than the first-year rates.

Key Assumptions/Sensitivities/Risk

Approximately 5,500 franchised car dealers, 1,200 rental and leasing companies and up to 8,000 other businesses (e.g. repair and other dealers) potentially affected by the measures. Estimate of roughly 175,000 affected vehicles a year, although there is some uncertainty around this figure.

Price Base Year 2009	Time Period Years 10	**Net Benefit Range** (NPV) **£ Up to £10-12½m over 10 yrs**	**NET BENEFIT** (NPV Best estimate) **£**

What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	1 April 2010			
Which organisation(s) will enforce the policy?	DVLA			
What is the total annual cost of enforcement for these organisations?	N/a			
Does enforcement comply with Hampton principles?	N/a			
Will implementation go beyond minimum EU requirements?	N/a			
What is the value of the proposed offsetting measure per year?	£ Nil			
What is the value of changes in greenhouse gas emissions?	~ £15m (NPV)			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro **N/a**	Small **N/a**	Medium **N/a**	Large **N/a**
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £	Decrease of £	**Net Impact**	**£** Negligible

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

Background

The Government announced at Budget 2008 – and confirmed in the Pre-Budget Report (PBR) 2008 – reforms to the system of vehicle excise duty (VED) for cars. As part of this reform, differential rates of VED on brand new cars ("first-year rates" or FYRs) will be introduced in 2010. FYRs are intended to act as a strong signal at the point of purchase that motorists can save money by buying a lower-carbon version of a new car within their preferred class (e.g. supermini, estate, hot-hatch, etc.). For lower-carbon new cars, FYRs will be zero, while for higher-carbon new cars, they will be higher than standard rates of VED. The reforms to VED are estimated to lead to a 0.9 million tonne reduction in carbon dioxide (CO2) by 2020. FYRs contribute a large part of this reduction. (This is down from 1.0 million tonnes of CO2 as announced in the PBR, due to the downturn in the car market).

VED is administered by the Driver and Vehicle Licensing Agency (DVLA). For reasons of practicality, DVLA can only charge FYRs on the first vehicle licence for a brand new vehicle. Subsequent licences - including those within the first year of ownership - will be charged at the standard rate of VED.

VED policy currently grants vehicle owners the option to license certain vehicles for six months, as opposed to the full twelve month period. VED policy also permits vehicle owners, under certain conditions, to obtain a refund on any unexpired complete months remaining on their vehicle licence when they no longer require that licence.

Policy rationale

Without reform to the VED rules on refunds, owners of higher-carbon new cars would be able to pay less than the full amount of FYR. For example, when a vehicle owner declares Statutory Off-Road Notification (SORN), they are entitled to receive a refund. If there were no reforms to the refund rules, once FYRs are introduced, the owner of a higher-carbon new car would be able to declare SORN for a short period and claim a refund, and then relicense the vehicle at the lower standard rate of VED. This would allow the owner to pay less than the full amount of FYR on a higher-carbon new car. The incentive to buy a lower-carbon car would be weakened, as would the environmental signal that FYRs are intended to send.

Owners of higher-carbon new cars would also be able to pay less than the full amount of FYR if no reform is made to the VED rules on six month licences. For example, if there were no reforms to the six month licensing rules, the owner of a higher-carbon new car would be able to license their car for six months, and, upon expiration of this period, relicense the car at the standard rate. This would allow the motorist to pay less than the full amount of the FYR on a higher-carbon new car. Again, this would weaken the signal that FYRs are intended to send, and reduce estimated environmental savings.

Policy options

In order to protect the environmental signal of FYRs, reforms to the VED rules on refunds and six month licences for higher-carbon new cars were considered. This resulted in four possible options for reform:

1) Do nothing.
2) Limit VED refunds on the first vehicle licence up to the standard rate for new cars in VED Bands H to M that are sold, transferred, exported, or that have made a SORN declaration.
3) Disallow refunds on the first vehicle licence for new cars in Bands H to M that are sold, transferred, exported, or that have made a SORN declaration.
4) Disallow six month VED licences to be taken out as the first vehicle licence for new cars in Bands H to M.

The first option was considered to be detrimental to the Government's environmental aims. Both options 2 and 3 would help protect the incentive to buy lower-carbon new cars, and concomitant environmental savings. Both would continue to allow owners to obtain a refund on higher-carbon new cars that have been stolen, written-off or become eligible for a nil rate of VED. However, option 2 was preferred over option 3. Option 3 would have allowed no refunds, apart from in the above circumstances. Option 2 continues to allow refunds in other circumstances, up to a portion of the rate that would have been charged, had not the FYR on the vehicle been higher than the standard rate (i.e., had the vehicle not been a higher-carbon new car). Option 4 will withdraw the policy permitting vehicle owners to take out a six month licence – as opposed to the full twelve month licence – for the first vehicle licence for higher-carbon new cars. It will help protect environmental savings by ensuring motorists do not pay less than the full amount of FYRs on higher-carbon new cars.

Number of cars and types of businesses affected

The focus of this impact assessment is on business impacts, although these policy measures will also affect private individuals who purchase brand new higher-carbon cars with a six month licence and/or apply for a VED refund on a first licence. The numbers affected are expected to be small compared with those buying all new cars, and even smaller compared with those buying all cars (both new and used). Many private new car purchases will have 12 months' VED included in the sales package.

There were 1.4 million fleet and business[1] new car registrations in 2007, making up 56 per cent of total new car registrations (the remaining 44 per cent, or 1 million, were private new car registrations). Roughly 35-40 per cent of these cars fall into the higher-carbon bands affected by the policy measures (VED Bands H to M, or 166g CO_2/km and above). The figure for 2008 new car registrations is 2.1 million, with fleet and business registrations making up 1.2 million (58 per cent) of the total.

Fleet and business cars are a mix of vehicles purchased for large and small rental fleets, lease cars that have been purchased to supply into one, two and three year agreements, manufacturer and dealer demonstrator models and individual business cars.

Businesses most likely to be affected by the policy measures are those that make extensive use of refunds and six month licences within the first year of ownership. We have identified franchised car dealers with demonstrators and national/large rental companies as those particularly affected, although other types of business, such as agents, could be too. Their vehicles are generally 'churned' (sold) after 3-9 months, and go into the second-hand market.

Based on information from DVLA about the approximate number of six month licences taken out on first registration, and assumptions about the distribution of CO_2 emissions from new cars, it is estimated that about 175,000 cars a year are potentially affected by the policy measures. These are higher-carbon (i.e. VED bands H to M) new cars registered by businesses with six months' VED.

Revenue impact

The Exchequer impact of the VED reforms is set out in Table A.1 of Budget 2008 and updated in Table B5 of PBR 2008. As explained in the PBR, to reduce pressure on motorists during the current economic downturn, there will be no significant rate changes until 2010. FYRs for new vehicles will be introduced in that year as announced in Budget 2008. The measures on VED refunds and six month licences mean that motorists cannot pay less than the full amount of FYR on new cars by taking a refund or a six month licence on the first vehicle licence, helping to deliver forecast revenue and protecting the environmental signal of the reforms to VED (see carbon and environmental assessment below).

Compliance costs

[1] A business user is defined as a company operating between 1 and 24 vehicles, while a fleet user operates 25 or more vehicles.

Restricting VED refunds for new cars in Bands H to M up to the value of the standard rate on the first licence will result in a financial cost for some businesses running higher-carbon vehicles. As explained above, the VED reforms aim to signal the environmental impact of different vehicle choices. This policy measure does not represent an additional compliance cost to business (i.e. the cost of complying with the tax system) even though it affects the amount of tax actually paid. Businesses will, however, need to familiarise themselves with the wider VED reforms and the details around refunds and six month licences for higher-carbon new cars, and then decide how to respond. This will give rise to certain costs. It may also involve some of the larger dealerships and rental companies consulting business advisers, but such costs would not be compulsory.

Familiarisation costs are estimated at up to £300,000 for the 15,000 or so car dealers, rental companies, lease companies and other businesses potentially affected, assuming an average of one hour familiarisation time per business.

Businesses that currently license a higher-carbon new car for six months will no longer be able to do so on the first vehicle licence. They will need to take out a 12 month licence instead, and then claim a VED refund if the vehicle is sold within the first year (or sell the vehicle with VED remaining and factor this into the selling price). When deciding on which new cars to purchase and when to dispose of them, businesses will need to take this into account alongside the fact that refunds on higher-carbon cars can only be obtained up to the value of the standard rate.

We expect an increase in VED refunds from these measures. The process for obtaining a refund involves businesses completing a V14 (Application for a refund of vehicle tax) and sending this together with the tax disc to DVLA (or taking it to a local DVLA office). Although the process is relatively straightforward and familiar to business, it does involve a compliance cost.

Based on the estimated number of cars affected and assumptions as to the turnover of vehicles in the main sectors affected, we estimate additional compliance costs could be around £250,000-£500,000 a year.

The net present value (NPV) of these costs, including one-off costs, over the 10 year period 2010-11 to 2020-21 is estimated at around £2½-5 million (in current prices), using the Government’s recommended discount rate of 3.5%.

Businesses unable to take out six month VED licences on higher-carbon new cars may experience decreased cash flow as a result of having to take out a 12 month licence instead. They will need to factor this into their decisions regarding vehicle purchase and disposal.

Benefits

The main benefit of these measures is that they protect the environmental signal of the VED reforms so that the policy works as intended and delivers carbon savings. As explained above, without changes to the VED rules on refunds and six month licences, owners of higher-carbon new cars would be able to pay less than the full amount of FYR by taking a refund or a six month licence on the first vehicle licence. This would weaken the environmental signal and also lead to a loss of revenue to the Exchequer.

The carbon and environmental assessment below gives more details on how the carbon savings from the VED reforms are valued.

Driver Vehicle and Licensing Agency costs

VED is administered by the DVLA. To implement the policy measures, DVLA’s VED systems will need to be updated to be able to differentiate between licences and refunds for first licence higher-carbon cars and all other vehicle licences. They are also likely to have to process more refund applications depending on how businesses react to the changes. This could be offset by fewer licence applications if some businesses decide to hold on to higher-carbon vehicles for longer instead of replacing them within the first year. Costs have not been quantified in this impact assessment.

There will also be staff training costs, but these are expected to be minimal. Providing general guidance on changes to the VED system is a routine part of DVLA's business and does not represent an additional cost.

Specific Impact Tests

Full details of the specific impact tests can be found at:

http://www.berr.gov.uk/whatwedo/bre/policy/scrutinising-new-regulations/preparing-impact-assessments/toolkit/page44263.html. These have been applied to the VED measures in this impact assessment.

Competition Assessment

All businesses buying or selling vehicles in a given emissions band will be affected equally by the VED reforms and the associated measures on refunds and six month licences for higher-carbon new cars, so competition between these businesses will be unaffected.

The VED reforms will alter the relative prices of high and low carbon cars, meaning that those buying lower-carbon vehicles within their preferred class will pay less than those buying a higher-carbon alternative. This will have a small but, nevertheless, important effect on competition within the car industry by helping to promote lower-emitting, more fuel-efficient vehicle choices. By reforming the VED system to strengthen the signal of the environmental impacts of different car types, this helps make the tax system more effective at delivering environmental aims. The measures on refunds and six month licences for higher-carbon new cars will help ensure that the policy works as intended by reducing opportunities to pay less than the full amount of FYRs.

Small Firms Impact Test

These measures apply equally to all businesses buying or selling cars in a given emissions class, irrespective of size. Large businesses will tend to buy more new cars than smaller businesses, and are also likely to change greater numbers of cars within the first year, making greater use of refunds and six month licences (particularly the large car dealers and rental companies). However, it is recognised that smaller dealers and hire firms will also be affected and that the restriction on six month licences for higher-carbon new cars could impact these businesses in terms of decreased cash flow in some instances. This has to be weighed against the benefits of these policy measures in terms of maintaining the environmental signal of FYRs.

Carbon and Other Environment

The reforms to VED, including FYRs, are estimated to deliver carbon savings of around 0.9 million tonnes of CO2 by 2020, compared with making no changes to the VED regime. These measures will help ensure that the environmental signal of FYRs is not weakened, and that the forecast carbon benefits are realised.

The estimated carbon savings can be valued (in terms of the avoided damage costs of climate change from fewer tonnes of CO2 emitted) using the 'shadow price of carbon' recommended by the Department of Energy and Climate Change for use in policy appraisal[2]. Using these values gives an average annual benefit of around £1.75 million over the 10-year period 2010-11 to 2020-21 from the FYR element of the VED reform package.

The NPV of the FYR carbon savings over this period is estimated at around £15 million (in current prices).

There will also be effects on other air pollutants, such as oxides of nitrogen and particulates, but these have not been quantified in this impact assessment.

Other impacts

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[2] See http://www.defra.gov.uk/environment/climatechange/research/carboncost/pdf/HowtouseSPC.pdf

These measures were assessed for their likely impact on legal aid, sustainable development, health, race, disability, gender or human rights issues, and we conclude that they do not impact; nor should they have a significantly different effect in rural areas.

The Government is always looking to improve its compliance cost estimates and would welcome feedback on this impact assessment.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

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