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CABINET

VEHICLE EXCISE DUTY

Memorandum by the Chancellor of the Exchequer

1. The previous Administration announced their intention to phase out Vehicle Excise Duty (VED) on petrol-driven vehicles and to replace it by increased petrol taxation. We decided to review this decision and an interdepartmental Report by officials is circulated with this memorandum. The Report gives the arguments for and against abolishing VED and offers a series of options. This paper describes the main issues as I see them. In my view the arguments point to keeping the tax.
2. Officials have identified two major points in favour of abolition:
 - a. staff savings
 - b. energy conservation.
3. I recognise that abolition would provide a significant contribution to the Lord President's staff saving exercise. If we were to abolish VED the total staff savings would be 2,400 to 2,600 over the next three years, with the possibility of further savings in the longer term. On the other hand, the review undertaken by the Minister of Transport has identified changes in the operation and administration of the tax that could produce staff savings of 1,100 to 1,600 with possible further savings in the long term. This means that if we decide to retain VED we are still in a position to announce substantial staff savings in this area.
4. The energy policy argument is that the abolition of VED and its replacement by an additional 19p petrol taxation would relate the tax burden more closely to actual use, and thus act as an incentive to fuel economy. But this argument assumes that a significant rise in petrol taxation is possible only if the overall tax burden on motoring remains substantially unchanged. This is not the case. In my judgment, abolition of VED would provide no more than a short term justification for increasing petrol taxes. Indeed this year I was able to secure a 10p addition to petrol taxation without

reference to VED, at a time when petrol prices were rising for other reasons. I accept that there are good revenue and energy policy reasons for aiming to increase the petrol duty, as and when we can, but our ability to do this certainly does not depend on making a compensatory reduction in VED.

5. As I see it, the choice we have to make is between the larger staff savings from abolition and the effects on the revenue of the loss of this tax instrument. I expect VED on petrol-driven vehicles to yield £875 million in 1979-80. The tax has not been revalorised since 1977. If next spring I were to increase it by no more than the inflation rate since April 1979, this would provide another £170 million; and revalorisation on an April 1978 basis would yield an increase in revenue of £280 million. (This contrasts with a maximum administrative saving of £15 million from abolition of VED.) I see no problem in securing increases in VED. The track record of VED in recent years, until the question of abolition arose, was good, with the tax rates broadly keeping pace with the retail price index.

6. Against this, I doubt whether I would be able to secure a flow of revenue from petrol taxation alone comparable to the flow if both VED and petrol duty were available to me. I have every intention of keeping petrol taxation at as high a level as economic circumstances permit. But petrol is an insecure tax base. Oil prices are uncertain, and, as I see it, we are to some extent in competition with the Organisation of Petroleum Exporting Countries (OPEC). There may be times when it would not be sensible for wider policy reasons to add further to the petrol price. Moreover, we cannot rule out the possibility of supply disruptions which could severely erode - if only for a time - tax receipts from this source.

7. With abolition, to avoid a loss of revenue in future, I would need to increase petrol taxation by sufficient to cover not only the current yield from VED but also its revalorisation in future years. In addition I would need to provide for the revalorisation of petrol duty itself. In money terms, therefore, the annual increases in petrol duty could be large and, in practice, may not always be acceptable. We are committed over the years ahead to secure substantial reductions in the income tax. This will not be easy given the scale of public expenditure I shall have to finance. I cannot look to Value Added Tax to provide additional revenue. It would, therefore, in my judgment not be prudent to limit the scope for income tax reductions by doing away with a well-established and secure source of revenue.

8. To sum up, I recommend that we should -

a. Agree to an announcement that it is our intention to retain VED on petrol-driven vehicles; this would be best made, in my view, in the next Budget statement.

b. Announce at the same time that we intend to simplify the structure of the tax with a view to making substantial savings in staff and other administrative costs.

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considers the issues arising from the review of VED announced by the Treasury on 13 May.

In the introduction, the report is in four sections.

BACKGROUND

The administration has decided that VED on petrol-driven vehicles will be abolished and the equivalent revenue obtained by a switch to a higher rate of excise on the playing of the change were suspended pending further consideration. (Para. 1)

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The benefits seen from abolition were that administrative costs would be eliminated, motorists taxed more fairly, and energy saved without the costs of the majority of motorists. (Para. 4)

The issues raised in the consultations about timing were the effects on the cost of diesel, on the vehicle registration system, and on the costs of petrol. The first of these will need to be considered if abolition is to proceed. (Para. 5-6)

Increases in petrol taxation needed to replace VED revenue is still not at all low. As petrol prices have risen sharply since November 1975 at 100% it would add proportionally even less to the retail price of petrol. (Para. 7)

Anti-tax saving in petrol consumption - put at up to 5 per cent in 1979 estimated at 3 to 5 per cent. But the saving might be double that in 1980. (Para. 8)

Impact on the motor industry is no longer a significant factor. (Para. 10)

REVIEW OF THE OPERATION OF VEHICLE EXCISE DUTYReport by the Inter-Departmental Working Group on Taxation and TransportSUMMARY

This report considers the issues arising from the review of VED announced by the Minister of Transport on 25 May.

2. Following the introduction, the report is in four sections.

SECTION I - BACKGROUND

3. The previous administration had decided that VED on petrol-driven vehicles should be abolished and the equivalent revenue obtained by a switch to a higher tax on petrol. Consultations on the phasing of the change were suspended pending the outcome of the review. (Para. 1)
4. The major benefits seen from abolition were that administrative costs would be cut, evasion eliminated, motorists taxed more fairly, and energy saved without increasing the costs of the majority of motorists. (Para. 4)
5. The main issues raised in the consultations about timing were the effects on the taxation of diesels, on the vehicle registration system, and on the costs of rural and business motorists. The first of these will need to be considered further if abolition is to proceed. (Paras. 5-6)
6. The increase in petrol taxation needed to replace VED revenue is still put at 19p a gallon. As petrol prices have risen sharply since November 1978 at 19p tax increase would now add proportionately much less to the retail price of petrol. (Paras. 7-8)
7. The short-term saving in petrol consumption - put at up to 5 per cent in 1978 - is now estimated at 3 to 3½ per cent. But the saving might be double that in the long-term. (Para. 9)
8. The impact on the motor industry is no longer a significant factor. (Para. 10)

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SECTION II - THE MAIN ISSUES

9. The arguments for VED abolition remain much as they were when the previous Government made its decision. The major argument against is fiscal. The importance the Government attaches to income tax reductions and cutting the size of the public sector means that Ministers will wish to pay particular attention to the fiscal arguments and the administrative savings. (Para. 11)
10. The switch from VED to petrol duty will do away entirely with the problem of VED evasion, at present estimated to be running at 7-9 per cent. (Para. 12)
11. A form of taxation which varies in direct proportion to the use made of a vehicle is regarded by many as fairer than the present flat rate VED. (Para. 13)
12. The saving of 3-3½ per cent of total petrol consumption - and perhaps double that in the long term - is particularly desirable now in the light of commitments given at the Tokyo Summit. The present price of petrol is in real terms only about 85 per cent of its 1975 peak. (Paras. 13-14)

Fiscal Considerations

13. VED on petrol-driven vehicles is estimated to yield £875 million in 1979/80, petrol duty £2,025 million and VAT on petrol £475 million. (Paras. 16-17)
14. To compensate for the loss of VED petrol taxation would have to increase by 19p at 1979 prices. The switch would be broadly neutral in its effects on the EPI. (Para. 18)
15. The long-term effects on the revenue are uncertain. The loss of an indirect tax instrument and additional weight put on petrol duty would reduce the Chancellor's already restricted freedom of manoeuvre and would limit the scope for cuts in income tax. Retention of VED could be combined with a policy of increasing petrol duty as economic circumstances permit. (Paras. 19-22)

B. Administrative and Staff Savings

16. The Driver and Vehicle Licensing Centre employs 4,650 people and its local offices 2,230. If VED on petrol-driven vehicles is abolished, staff will still be needed to issue driver licences, maintain the vehicle register and handle VED on other vehicles. (Para. 23)

17. Transfer of work to post offices saving between 800 and 1,450 staff is a possibility whether or not VED on petrol-driven vehicles is retained. The precise number of staff saved would depend on what other changes are made. (Para. 24)

18. Abolition of VED would save 1,600 staff. With the transfer of most or all registration work to post offices the total saving would be 2,400-2,600. The financial saving would be £15 million p.a. A £2 fee to cover the cost of registration would yield £28 million p.a. (Para. 25)

19. In the longer-term it might be possible to save a further 1,100 staff if insurance companies were prepared to take on part of the work of registration. (Para. 26)

20. Retention of VED could produce a total saving of between 1,100 and 1,600 staff. In addition to transferring work to the post office, this could be achieved by abolishing four-monthly licences or replacing them by six-monthlies, by abolishing refunds or by changing the basis of VED to a tax on the possession (rather than the use) of a vehicle. (Paras. 27-34)

21. Timing: The basic changes would need to be implemented before replacement of the main computers in 1983. A tax on possession or an insurance-linked registration scheme might take longer. (Paras. 35-37)

22. Disabled motorists at present exempt from VED would lose this benefit if VED were abolished. Compensation could cost up to £8 million. The cost of running public service vehicles would also be increased. (Paras. 38-39)

SECTION III - OTHER POSSIBLE VED REFORMS

23. Two other possible changes are considered. (Para. 40)

24. A simpler rate structure: A radical reduction of the 250 VED rates covering eg. light goods and farm vehicles would make the system easier for the public to understand. Some motorists would fare worse and legislation could be controversial. (Para. 41).

25. A graduated VED system might be thought fairer (ie. more on Rolls-Royces than Minis) and might enable more revenue to be raised. But a tax based on cubic capacity (the most easily practicable base) would yield only small energy savings and is strongly opposed by the motor industry as an artificial constraint on design. The Group does not recommend it. (Para. 42)

SECTION IV - CONCLUSIONS AND POINTS FOR DECISIONS

26. The main arguments are summarised. An early decision is needed in view of the Lord President's present exercise. (Paras. 43-45)

27. Ministers are invited:

(a) To decide whether VED on petrol-driven vehicles should be abolished or retained.

(b) If VED is to be abolished:

(i) to authorise the early resumption of the suspended consultations;

(ii) to decide whether discussions should be opened on the possibility of an insurance-linked registration system.

(c) If VED is to be retained:

(i) to consider whether staff savings should be sought and, if so, what they should be;

(ii) to consider whether the possibility of graduated rates of duty for cars should be pursued further.

REVIEW OF THE OPERATION OF VEHICLE EXCISE DUTY

The Minister of Transport announced on 25 May that he intended to review the operation of vehicle excise duty. The background to the review was the decision of the previous Administration, announced last November, to phase out the duty on petrol-driven vehicles by 1983 and replace it by increased petrol taxation. Consultations over the timing of the changeover and related issues were still in progress at the time of the election: they were suspended by the new Government pending the outcome of the review.

2. The purpose of this report is to put before Ministers the issues relevant to the decisions to be taken on the future of VED. It has been prepared by the interdepartmental Group on Taxation and Transport under Treasury chairmanship; and officials of the Ministry of Agriculture, Fisheries and Food, the Central Policy Review Staff, Customs and Excise, the Civil Service Department, the Departments of Energy, Industry and Transport, and the Home and Welsh Offices have participated in its preparation.

3. The report is in four main parts. The first examines the background, including developments since the announcement by the previous administration of its intention to abolish the duty on petrol-driven vehicles. The second considers the main issues that bear on a decision on the future of the duty: and examines in detail the fiscal considerations, and the administrative and other savings and costs that could flow from a decision to abolish or retain it. The third deals with two possible changes that might be made in the structure of VED if it were retained: a simplification of the rate structure and the introduction of differential rates of the duty for cars. The final section summarises the case for and against abolition, and lists the points on which decisions will need to be taken.

The main concern expressed in Parliament and in letters from officials was about the effects on rural and business .../

I. BACKGROUND

4. The background to the previous Administration's decision was set out in paper 'The Future of Vehicle Excise Duty' issued by the Department of Transport in November 1978. The main benefits stated in the paper for the decision to abolish VED on petrol-driven vehicles and replace the revenue by an increase in petrol taxation were that administrative costs would be cut, evasion eliminated, the motoring taxes put on to a fairer basis, and energy saved without increasing the costs of the majority of motorists. The intention was to phase the change over a period, subject to the completion of the process by 1983 when replacement of the main computers at the Driver and Vehicle Licensing Centre needs to be undertaken.

Views of Interested Parties

5. The views of the main interested parties are summarised in Annex 1. As might be expected, the majority of the representations received following the announcement of the decision were from those opposed to the change but a number were in favour, particularly those from bodies concerned with energy conservation. In the subsequent consultations on the timing of the changeover particular concern was expressed about the effects of abolition of VED on petrol-driven vehicles on:

- (a) the effectiveness of vehicle registration system;
- (b) the future taxation of diesel-powered vehicles.

Most bodies were reluctant to commit themselves on timing until proposals on (a) and (b) had been formulated. Complaints were also received from petrol users who do not pay VED (eg. users of aviation spirit). These and a number of other issues which have arisen in connection with abolition are discussed in Annex 2.

6. The main concern expressed in Parliament and in letters from individuals was about the effects on rural and business motorists. A note on motoring costs is at Annex 3.

Recent Developments

7. The previous Government's information paper estimated that to compensate for the loss of the revenue obtained from VED in 1978/79 petrol taxation would have needed to be increased by 19p at 1978 prices. The increase required at 1979 prices to replace the 1979/80 VED revenue remains at 19p, mainly because the £50 rate of VED has not been increased. Petrol prices have, however, risen sharply in money terms this year as a result of the increase in crude oil prices and the tax changes in the June 1979 Budget. The average price is currently about 120p a gallon compared with about 80p in November 1978. A 19p increase in petrol taxation is therefore now a significantly smaller proportion of the retail price than it was in 1978.

8. This has two consequences so far as the implications of a switch from VED to petrol taxation is concerned. The first is that the energy savings to be gained from the switch are now reduced. The second is that a 19p increase in petrol taxation should now have less effect on the market for UK manufactured cars than was assumed in past discussions.

9. On the first point, the information paper estimated that a 19p increase in petrol taxation at 1978 prices would have reduced the demand for petrol in the short-term by about 5 per cent. Assuming that 19p were to be added to present petrol prices, the short-term savings are now put at between 3 and 3½ per cent. However, the savings should be larger - perhaps double - in the longer-term as motorists invest in more fuel-economical vehicles.

10. In the past, one of the major arguments against VED abolition was assumed to be the effect on the motor industry. The concern was that a large increase in petrol taxation would encourage rapid trading down to smaller and more fuel-efficient vehicles where the UK industry has traditionally been at its weakest and least profitable. However, in view of the recent rise in the price of petrol, and the industry's commitment to meet better fuel economy targets, it seems unlikely now that a 19p increase in petrol prices would have any appreciable effect on the volume or pattern of car demand. The car manufacturers would however expect to be consulted again about the timing of a change.

II. THE MAIN ISSUES

11. Apart from the administrative savings, the main reasons advanced in the previous Government's information paper for a switch from VED to petrol taxation were that it would end evasion, put the motoring taxes on a fairer basis and encourage fuel economy. These points are considered in paragraphs 12-15 below. The importance that the Government attaches to income tax reductions and to cutting the size of the public sector means, however, that Ministers will wish to devote particular attention to the fiscal policy implications and the scope for administrative and staff savings (both in the Department of Transport and the possible impact on other public spending programmes). Accordingly these issues are examined in greater detail in the following section of this report.

Evasion

12. It is estimated that evasion of VED on cars is running at about 7-9 per cent. Evasion erodes the revenue and annoys the majority of motorists who pay their duty and resent subsidising the dishonest minority. It is virtually impossible to evade petrol tax and abolition would therefore solve this problem with consequential savings to police and courts. If VED is retained and enforcement staff increased (by about 150) it is hoped that evasion can be reduced from its present estimated level to about 5-8 per cent.

Fairness

13. VED is a fixed cost paid annually (or in three instalments) and bears no relationship to the amount the car is used. Petrol tax, on the other hand, varies in direct proportion to mileage covered. It could therefore be regarded as a fairer method of taxation.

Energy Savings

14. Unlike VED, which is a fixed lump sum, petrol taxation

varies in direct proportion to the mileage covered and the fuel consumption of the car. A switch from VED to petrol taxation may therefore be expected to reduce petrol consumption: as noted in paragraph 9, the savings should be of the order of 3 to 3½ per cent of total petrol consumption in the short-term, and perhaps double that in the longer-term. In balance of payments terms, this would be a saving on imported petrol of around £100 million in the short-term, and up to £200 million in the longer-term. A reduction in demand for petrol would also help to improve UK refinery balance: the UK is likely to remain a net importer of petrol.

15. The need to make savings in petrol consumption is now particularly important. Following the recent political events in Iran, the UK has given commitments, both at the Tokyo Summit and subsequently in conjunction with our EEC partners, to limit oil imports in the years to 1985. Petrol consumption accounts for the largest single use of any oil product in the UK, and (except where fossil fuels can be substituted directly for oil, for example, in power stations) offers the greatest potential scope for containing oil demand. Petrol prices in the UK, even after the tax increases in the June Budget, are still in real terms only about 85 per cent of the peak price of 1975. The overall burden of motoring taxes in the UK (VED, fuel duty, VAT and car tax) is less closely related to fuel consumption than in most other EEC countries.

Fiscal Policy Considerations

16. VED on petrol-driven vehicles is estimated to raise £875 million in 1979/80 - about 4 per cent of the total revenue from indirect taxation. It is charged at an annual rate of £50 on all cars in use on the road and there are graduated rates for other vehicles. Taxpayers may opt for four-monthly, rather than annual, licences but must pay a 10 per cent surcharge (equivalent to an annual rate of £55 on cars).

17. Petrol duty is charged at a rate equivalent to just under 37p a gallon on all petrol delivered for use in the domestic

economy and is reflected in the retail price at the pump. VAT is charged on petrol at 15 per cent. On a full year basis, the duty on petrol is estimated to raise £2,025 million and VAT on petrol about £475 million in 1979/80.

18. As noted in paragraph 7 above, the increase in petrol taxation required to compensate for the loss of VED on petrol-driven vehicles is 19p a gallon at 1979 prices (16½p duty and 2½p VAT). The changeover would be broadly neutral in its effect on the RPI.

19. A switch from VED to petrol taxation should also in principle be neutral in its effects on the revenue. But maintenance of the revenue in real terms would require additional increases in petrol duty in the period up to 1982/83 to take account of the general increase in prices and the declining real value of VED (assuming that VED were not increased in money terms during the changeover). And once the changeover was complete regular further increases would be required if the revenue from petrol duty was to be maintained at the same level in real terms as the present revenue from petrol and VED combined.

20. Ministers will wish to judge whether this will be feasible given the political and presentational difficulties of large increases in the petrol duty. It is arguable that petrol cannot be relied upon to be a buoyant source of revenue given the risks of disruption of supplies and of sudden and rapid price increases imposed by overseas suppliers. Reliance on petrol taxation alone could therefore result in a lower contribution to the revenue from the motoring taxes. Furthermore, a failure to secure regular revalorisation of the petrol duty would mean that the benefits to energy conservation assumed to flow from the abolition of VED would not be fully achieved.

21. The major disadvantage of abolishing VED, however, is that it would reduce the Chancellor's freedom of manoeuvre making it more difficult for him to manage the indirect taxes and to provide scope for cuts in the income tax. The range of indirect tax instruments available for this purpose is already very limited.

An undertaking has been given not to increase VAT further during this Parliament. The only other broadly-based and buoyant source of indirect tax revenue is the National Insurance Surcharge and the problem about this tax is that it adds to industrial costs and reduces company liquidity - particularly unwelcome in the circumstances likely to prevail over the next year or so. That leaves only the duties on oil, alcohol and tobacco.

22. Against this background, the abolition of VED as a quid pro quo for an increase in the petrol duty implies a loss of potential revenue since the taxable capacity of petrol is available whether VED is changed or not. Abolition simply offers a presentational advantage in terms of the justification to the motorist of the increase in petrol duty. Retention of VED on the other hand would give the Chancellor a useful measure of flexibility and could still be combined with a policy of increasing the petrol duty to as high a level as economic circumstances permit in the interests both of the revenue and of energy saving.

Administrative and Staff Savings

23. In 1980/81 the Driver and Vehicle Licensing Centre is expected to employ 4,650 people and its 82 local offices 2,230. The organisation exists to perform three main functions: to issue driving licences, to maintain a vehicle register, and to collect and enforce vehicle excise duty on petrol-driven and other vehicles. The first two functions (undertaken entirely by DVLC) would continue whether VED was retained on petrol-driven vehicles or not. Only the issue of vehicle licences (currently divided between the local vehicle licensing offices and some 2,000 post offices) and enforcement (divided between DVLC and LVLOs) would be affected by abolition. For petrol-driven vehicles the licensing process (which provides an in-put to the vehicle register as well as a means of collecting tax) would be replaced by some form of annual registration; enforcement would continue but in a simplified form and at a lower level of effort.

24. Whether or not VED is retained on petrol-driven vehicles, post offices could take over the LVLOs' share of vehicle licensing

(or the registration process that might replace it). The staff saving at LVLOs would vary between 800 and 1,450 according to the amount of work that had been eliminated before the transfer took place, and whether the Post Office could handle the more complicated first registration transactions. Post Office charges would offset the saving in staff costs so there would be no net financial saving. There would however be a resource saving as the Post Office would absorb most of the work with their existing staff: they would expect to recruit only another 200-300. The change would also provide a more convenient service for the motoring public.

ABOLITION

25. The abolition of VED on petrol-driven vehicles would provide a further saving of 1,600 staff (670 at DVLC and 930 at LVLOs). These would come mainly from the elimination of four-monthly licensing and of refunds, and from reductions in enforcement. The transfer of registration work to post offices would add a further saving of 800 - 1,000 staff (all at LVLOs), bring the total staff saving to 2,400 - 2,600. There would be an equivalent financial saving of £15 million p.a. The cost of the registration system would be recovered through an annual registration fee. A fee of £2 would approximately cover current costs and would provide additional revenue of £28 million p.a.

26. For the longer-term the Department of Transport could consider with the insurance companies whether it might be practicable to combine registration with motor insurance eg. companies might renew policies, issue a windscreen disc to record both insurance and registration, and pass DVLC whatever details they needed to up-date the vehicle register. The companies would thus take over the work which had earlier been transferred to post offices. Unlike the post offices, however, they might be expected to pass information to DVLC in computer readable form. If all the information could be provided in this way there would be a further saving of 1,100 staff (all at DVLC) bringing the total to 3500-3700. Whether there would be a financial saving would depend on the charges raised by the insurance companies for the additional work they would be

doing. It has not yet been established that the change would be practicable and it could not be implemented before DVLC replace their mainframe computers in 1983-85. But if practicable it could provide both a more effective registration system and easier enforcement of insurance.

...additional revenue of 15 million p.a. (again after allowing for rates of interest) by comparison with that obtained from four-monthly licences.

27. If Ministers decide that VED is to be retained there are three possible ways in which savings additional to those arising from transferring licensing to post offices might be obtained:-

- (a) by abolishing four-monthly licences or replacing them by six-monthlies;
- (b) by abolishing refunds;
- (c) by making VED a tax on the possession of a vehicle rather than its use on the public road.

These savings would however be partly offset by the increase of 150 which would be needed in the staff employed on enforcement, at an administrative cost of £1 million p.a.

(a) Abolition of four-monthly licences

28. The abolition of four-monthly licences (used by 5.5 million vehicle owners) would run counter to the present trend of allowing bills to be paid by instalments. It would save 100 staff at DVLC and 450 staff at LVLOs. (The LVLO staff would however be saved anyway if their work was transferred to post offices.) There would be a saving in administrative costs of £8 million p.a. The loss of revenue from the 10 per cent surcharge on the four-monthly licence (after allowing for realistic rates of interest on the deferred payments) would be £22 million p.a. at current rates of duty.

...public roads. A tax on possession would mean that a vehicle would remain taxed throughout its lifetime; in other words, no refunds would be available and no gaps in licensing would be.../

29. The replacement of four-monthly licences by six-monthlies would save 50 staff at DVLC and 250 staff at LVLOs. (The LVLO staff would again be saved anyway by transferring the work to post offices.) There would be a financial saving of £4 million p.a. In addition a 10 per cent surcharge on a six-monthly licence would produce additional revenue of £4 million p.a. (again after allowing for realistic rates of interest) by comparison with that obtained on four-monthly licences.

30. The effect of abolishing or lengthening short-period licences could be tempered by a savings stamp scheme. This might be introduced before any change took place (or even if there was not to be a change at all). It would probably be widely used, although initially motorists would have both to pay for their existing licence and buy stamps for a new one. The scheme might slightly increase costs - the Post Office would charge more for handling licences if they had to accept stamps. The Department of Transport is pursuing the possibility.

(b) Abolition of refunds

31. The main effect of abolishing refunds (of which there are around $1\frac{1}{2}$ million a year) would be to prevent dealers (and private motorists) selling second hand cars from trading in the unexpired licence. (This would presumably be reflected in the subsequent sale price.) Motorists whose vehicles were off the road for lengthy repairs or because they themselves were ill or abroad would also be worse off. There would be a staff saving of 200 (all at DVLC) and an equivalent financial saving of £1 million p.a. In addition there would be a gain to the revenue of upwards of £5 million p.a.

(c) Tax on possession

32. VED is at present chargeable on a vehicle only if it is used on the public roads. A tax on possession would mean that a vehicle had to remain taxed throughout its lifetime; in other words, no refunds would be available and no gaps in licensing would be

permitted. As with abolition, those most affected would be sellers of secondhand vehicles and motorists who for reasons beyond their control had to keep their vehicle off the roads. Administrative savings would also be the same as from the abolition of refunds: 200 staff and £1 million p.a. There would be a gain to the revenue of around £20 million p.a. In the short-term there might be some increase in evasion, but the change would open the way to improved methods of enforcement on the basis of the computer record instead of solely on on-the-road checks on licence discs. This could offer further savings of perhaps 2-300 staff and £2 million p.a.

33. In theory all three of these changes could be considered separately. In practice abolition of four-monthly licences and of refunds ought to be taken together: abolition of one by itself is otherwise likely to lead to an increase in demand for the other. A tax on possession would do away with the need for refunds but it could be combined with the continuation of short period licences, since there would be no incentive to switch to a shorter licence in expectation of a vehicle being temporarily off the road. Any of these options might be expected to lead, in the short term at least, to some increase in evasion: this could lead to some erosion of the savings if extra staff were required to deal with this increase.

34. The savings under each of these options and from VED abolition are set out in the table on the following page. The figures take account of the need, if VED is retained, to increase enforcement staff as referred to in paragraph 21.

TIMING

35. With the exception of the insurance-linked registration scheme and possibly the new methods of enforcement allowed by a tax on possession, all the changes discussed in this paper could be implemented before DVLC begins to replace its mainframe computers at the start of 1983. Even the changes practicable before 1983

Before End-1982

Longer Term

		Before End-1982			Longer Term	
		Staff	£pa	Staff	£pa	
		Net Saving from Change in Licensing Task (after deducting extra 150 staff required for enforcement if VED is retained)	Saving From Transfer of Work to Post Offices*	Net Total *		
Abolition of VED		1600	1000	2600	15m	1100 (max) Not known
Retention of VED	<u>Abolition of 4 monthly licences</u>					
	Without other change	400	1000	1400	7m	-
	With refunds abolished	600	1000	1600	8m	-
	With tax on possession	600	1000	1600	8m	2-300 2m
	<u>Replacement of 4 monthly licences by 6 monthlies</u>					
	Without other change	150	1200	1350	3m	-
	With tax on possession	350	1200	1550	4m	2-300 2m
	<u>Retention of 4 monthly licences</u>					
Without other change	-150	1450	1300	-1m	-	
With tax on possession	50	1450	1500	Neutral	2-300 2m	

NB. The Department of Transport are not at present able to say whether the changes to the vehicle registration system needed the new methods of enforcement could be completed before they begin to replace the computers at DVLC in 1983 but they would try to make them before that date. It would not be possible to change to an insurance-linked registration system until after replacement of the computers had been completed in 1985.

* The figures in these columns will need to be reduced by 200 if post offices cannot handle first registration.

involve several months' preparatory work and phasing would be essential. Priority would be given to changes which did most to reduce the work load (abolition of VED or replacement/abolition of four-monthly licences); the staged transfer of work to post offices and any change to a tax on possession and new methods of enforcement could follow.

36. Legislation would be required for all the changes except the transfer of work to post offices, but all except that required for a change to a tax on possession would not be complex.

37. Although there would not be time to introduce an insurance-linked registration scheme (if one is practicable) before 1983, a joint study with the insurance companies might be initiated as soon as any decision to abolish VED was announced.

OTHER PUBLIC EXPENDITURE COSTS

38. The most important effect on Government spending programmes other than for the Department of Transport, the police or the courts would be on benefits for the disabled. At present various groups enjoy full exemption from VED, and would lose this if the cost of VED were transferred to petrol prices. There would be considerable pressure to compensate them for this loss. DHSS estimate that compensation could cost up to £8 million a year.

39. Many public service vehicles (for example, Crown vehicles, ambulances, fire engines) are also exempt from VED. The transfer of VED to petrol prices would add to costs on the public expenditure programmes concerned.

III. OTHER POSSIBLE REFORMS IN VED STRUCTURE

40. The Group has also considered two other possible changes which might be made in the structure of VED if it is retained.

41. The first is a simplification of the rate structure. There are at present some 250 rates of VED covering vehicles other than cars and heavy lorries, eg. lighter goods vehicles, and agricultural and other machines. Simplification of tax classes and rates would make the system easier for the public to understand and would facilitate the transfer of work to post offices. It should be possible to make the change without loss of revenue. But the elimination of some special rates and merging of others would inevitably mean that some vehicle owners would lose (or not gain as much as they thought they should). The legislation could therefore be controversial.

42. The second possible change is to a graduated system of VED. The suggestion is frequently made (most recently by the former Secretary of State for Transport) that a graduated system of VED would encourage the purchase of more energy-efficient cars and make the tax more progressive. Almost all EEC countries levy their VED equivalent on a scale and a recent EEC study has suggested that this was a positive though minor factor influencing consumers to purchase more economical cars. The energy savings, however, are likely to be small. The most easily practicable basis for a graduated system would be the cubic capacity of the engine. This is not an accurate guide to the fuel economy of a car and is likely to become less so. The old graduated system of VED (based on h.p. rating) was abolished in 1948 because it imposed artificial constraints on engine design, and this objection still applies. The motor industry have made it clear that they would be strongly opposed to its reintroduction. The main advantage of a graduated scale would be presentational - many people regard the present system, whereby a Mini is liable to the same VED as a Rolls-Royce, as unfair. A graduated scale might therefore make it easier to raise more revenue from VED. But the Group concluded that the disadvantages would outweigh any gains and that a graduated VED was not an option worth pursuing further.

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IV. SUMMARY OF CONCLUSIONS

43. The background has changed in a number of respects since the Labour Government announced its decision to abolish VED on petrol-driven vehicles in November 1978. The recent increases in oil prices mean that the energy savings to be gained from the compensating petrol tax increase are lower than they would have been last year, though with a potential benefit of £100 million to the balance of payments in the short-term, and up to £200 million in the long-term, they are still worthwhile. The impact of the petrol tax increase on the motor industry is now a less significant factor in the debate than it has been in past years. But the arguments that abolition will dispose of the problem of VED evasion and that the switch could mean a fairer basis for the motoring taxes, are still valid.

44. In view of the importance the Government attaches to income tax reductions and to cutting the size of the public sector Ministers will wish to give special consideration to the fiscal arguments and the administrative savings.

The fiscal argument against the abolition of VED is that it would deprive the Chancellor of a useful tax instrument and, by increasing his dependence on petrol duty as a source of indirect tax revenue, could reduce the scope for future income tax reductions. Retention of VED would allow for more flexibility in raising indirect taxation and could be combined with increasing petrol duty as high as economic circumstances permit.

The administrative argument for abolition is that it would produce direct savings of 1,600 staff and £15 million by the end of 1982, with possibly an additional saving of 1,000 staff within the same timescale from transferring the residual work on registration to post offices, and a further saving of 1,100 staff in the longer-term if the insurance companies were prepared to take on part of the work of maintaining the vehicle register. It would be a highly visible expression of the Government's determination to reduce the size and cost of the civil service.

If VED were retained, the maximum net saving would in the short-term be 600 staff and £8 million p.a. (even if unpopular measures such as abolition of short-period licences and refunds were taken), with possibly another 1,000 from transferring work to post offices and in the longer-term 200-300 staff and £2 million p.a. from improved methods of enforcement direct from the computer record.

45. The question of the future of VED is closely bound up with the Lord President's present exercise on staff savings. It would be difficult for the Government to announce a major package of measures and to have to say that no decision had yet been reached on savings on VED. An early decision is therefore needed.

46. Ministers are invited:

(a) To decide whether VED on petrol-driven vehicles should be abolished or retained.

(b) If VED is to be abolished:

(i) to authorise the early resumption of consultations about timing, diesel taxation and other related issues;

(ii) to decide whether discussions should be opened on the possibility of an insurance-linked registration system.

(c) If VED is to be retained:

(i) to consider whether staff savings should be sought and, if so, what they should be (i.e. should short-period licences and refunds be abolished, and should a tax on possession be introduced?);

(ii) to consider whether the possibility of graduated rates of duty for cars should be pursued further.

VIEWS OF INTERESTED PARTIES

Following the previous Government's announcement of its decision to abolish VED, meetings to discuss the timing of the phasing process and other related issues were held with the three main organisations concerned: the Society of Motor Manufacturers and Traders (representing the UK car industry), the Petroleum Industry Advisory Council (representing the oil companies) and the Motor Agents Association (representing the independent petrol retailers). None was prepared to give a final view on timing without further information on, for example, the Government's intentions on diesel taxation. Their main concerns were:-

- (a) the size of the compensating petrol tax increase (which all three sought - on different grounds - to challenge);
- (b) the viability of the post-VED registration system (SMMT);
- (c) the implications of the petrol tax increase and associated costs for an already contracting trade (MAA and to a lesser extent PIAC).

2. A large number of written representations, both from organisations and individual members of the public, were also received. As might be expected, the bulk of correspondence was from people who objected to the change, though a number of MPs from both sides expressed support for the proposal on the grounds that it would reduce tax evasion and bureaucracy. The major organisations who wrote included the Confederation of British Industry, Automobile Association, Royal Automobile Club, National Consumer Council, the Retail Consortium, the Freight Transport Association and the National Farmers Union.

- (1) Almost all objected to the lack of prior consultation.
- (2) Other objections, either to the detail or the broad principles of the proposal, were

- (a) the effect that the change would have on high mileage motorists (including many business users) who would incur higher costs;
- (b) concern about the enforcement of MOT testing, insurance and registration requirements;
- (c) worries about essential rural use, especially in Scotland, and the effect on tourism;
- (d) complaints from retailers that they would face additional compliance costs (financing the duty, increased cash handling etc.);
- (e) queries about the basis for the calculation that an increase of 19p a gallon would be needed on petrol taxation to compensate for the loss of VED revenue.

3. Those enjoying concessionary rates of VED protested about the increase in costs for agricultural vehicles, taxis, motorcycles and disabled motorists. The main complaint came from people who use petrol (or other light oil) and do not pay VED. The best organised lobby was light aviation (over 110 separate representations have been received) who sought exemption from any duty increase to be imposed to recoup the revenue from VED.

4. About 20 organisations have been in favour of the switch. These include various conservation groups, the Advisory Council on Energy Conservation, the National Union of Railwaymen and the National Consumer Council - the last on the grounds that the switch will help those on lower incomes and encourage fuel economy.

Insurance, the likelihood of its being taken seriously would be very greatly strengthened. Since the disc would cover insurance as well as registration the enforcement of insurance would be strengthened as well.

5. If VED is retained, the position will be broadly as now, though increased enforcement should lead to improve the accuracy of the register.

ISSUES CONNECTED WITH VED ABOLITION

There are a number of issues in connection with the abolition of VED on petrol-driven vehicles which would need to be considered further if Ministers decide to proceed with abolition. The main points are summarised in this note.

A. The Vehicle Registration System

2. The vehicle register maintained by DVLC is used not only for the enforcement of VED but also to trace drivers involved in traffic or other offences (including serious crime) or in accidents; to recall defective vehicles; and to provide essential marketing information for the motor industry. If VED were abolished, all this would have to continue.
3. The SMMT, in particular, have expressed the fear that without VED the motoring public would fail to take an obligation for annual re-registration seriously. The requirement would however still be enforced: there would still be a wind-screen disc and anyone not displaying it would be committing an offence. The abolition of VED would itself remove the major disincentive to re-register/re-licensing. It is a matter of judgement whether the requirement to re-register would be likely to be taken more seriously with or without an administrative fee (the normal policy is to charge one) but on the whole it seems likely that a fee would help to ensure that it was taken seriously.
4. If, in the longer-term, registration could be linked with insurance, the likelihood of its being taken seriously would be very greatly strengthened. Since the disc would cover insurance as well as registration the enforcement of insurance would be strengthened as well.
5. If VED is retained, the position will be broadly as now, though increased enforcement should tend to improve the accuracy of the register.

3. The Taxation of Diesel-Powered Vehicles

6. The motor manufacturers said that they could not comment adequately on the main proposal to abolish VED on petrol-driven vehicles until the proposals for the future taxation of diesel were known. A separate consultation paper was promised but was still in preparation when consultations were suspended.

7. There are a number of related issues concerning the taxation of diesel vehicles and the duty on diesel road fuel (DERV) on which decisions will need to be taken if VED on petrol-driven vehicles is abolished. Heavy goods vehicles are all diesel-powered. Proposals for restructuring VED for these vehicles to reflect more closely road costs were made in a consultative document issued by the Minister of Transport on 3 August: these proposals apply irrespective of the outcome of the wider review of VED. But if Ministers decide in favour of abolition on petrol vehicles, there would be a strong case for increasing diesel duty as with petrol duty and abolishing VED on the lighter goods vehicles diesel cars. VED would then only be payable on the 275,000 heaviest lorries.

8. Traditionally, the duty on petrol and diesel fuel has been the same, but since 1977 when a proposed increase in petrol duty was lost, diesel has been dutied at 5p per gallon more than petrol. On energy conservation and refinery balance grounds there are arguments for a more favourable treatment of diesel fuel, but these arguments need to be weighed against the fact that the UK motor industry does not at present produce a diesel car and has no immediate capacity to do so. The motor industry, through the SMMT, have stated that they see no case for subsidising either diesel or petrol engined vehicles and that the present tax disadvantage to diesel fuel should be removed.

C. Electric Vehicles

9. The then Financial Secretary announced on 2 April that VED on electric vehicles would be abolished along with that on petrol-driven vehicles. There is a strong case on energy policy and environmental grounds for encouraging the development of electric vehicles. There are at present only about 34,000 electric vehicles liable to pay VED, the vast majority of them being milk floats, and the cost to the revenue of abolishing VED on these vehicles would be less than £2 million a year.

10. A decision to abolish VED on electric vehicles could be taken independently of the outcome of the wider review for announcement as part of either an abolition or retention package.

D. Non-Road Users of Petrol

11. The increased cost of petrol for motorists would be offset by the abolition of VED, but other users of petrol would have to pay the extra petrol taxation with no compensating saving. There has been considerable protest from people who use petrol but do not pay VED about the proposal to recoup VED revenue by additional taxation of light hydrocarbon oil. They obviously have reasonable grounds for complaint, but any attempt to relieve petrol not for road fuel use from the duty increase would cause severe enforcement problems for Customs and Excise.

12. The best organised and most vocal lobby are the users of light aircraft which run on aviation spirit (AVGAS). They claim that it would be possible to distinguish AVGAS from other petrol and the danger of evasion of full-rate petrol duty would be small. If the decision were to go ahead with abolition of VED it would be necessary to consider whether a concession to light aviation were practicable and justifiable. It would be out of the question to make a similar kind of concession to other petrol users, since such a relief would be impossible to control.

EFFECT OF VED ABOLITION ON MOTORING COSTSGeneral

1. With a petrol tax increase of 19p a gallon, the two-thirds of motorists who at present take out annual licences would need to use 260 gallons a year before they began to pay more tax as a result of abolition; the one-third who take out 4-monthly licences (on which they pay a surcharge of 10 per cent) would need to use about 290 gallons.

2. These gallonage figures represent the following break even annual mileages:

	<u>At 25 mpg</u>	<u>At 30 mpg</u>	<u>At 35 mpg</u>
260 gallons.....	6500	7900	9100
290 gallons.....	7250	8700	10150

3. The average mileage of motorists in Great Britain is 8700 miles a year, of which about 10 per cent of the mileage done by privately owned cars is for business purposes. But the average mileage is also weighted by the very high mileage done by a relatively small number of motorists. Some $7\frac{1}{2}$ out of 14 million motorists do less than 8000 miles (including business motoring) and would be likely to break even or gain from abolition. Another 1 million do less than 8000 miles private motoring, although they do some business motoring in addition. About 5 million motorists do between 8000 and 15,000 miles and if this was all private mileage and they paid for VED, could lose up to £45 a year. The remaining $1\frac{1}{2}$ million motorists who also do over 15,000 miles a year would find their costs increased by more than this. However, at the higher mileages, a substantial proportion of motoring is done for business purposes and the VAT element in the petrol tax increase would be deductible.

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Business Motorists

4. In general business motorists cover substantially higher mileages than private motorists and hence, in most cases, would face an increase in costs as a result of a switch from VED to petrol taxation. The increase in total business costs is estimated to be of the order of £100 millions. To the extent that this could not be passed on immediately in higher prices, there would be a worsening of business liquidity.

Rural Motorists

5. About 3 million out of 14 million motorists are defined in the National Travel Survey as 'rural'. The average annual mileage for rural motorists is about 9700 miles on private and business motoring compared with the national average of 8700. (About 2000 of this 9700 is accounted for by business motoring). Family Expenditure Survey data indicate that rural motorists generally obtain better than average fuel consumption, presumably because they drive on less congested roads. At 35 mpg the rural motorist on average mileage who had been buying an annual licence would be about £2.50 a year worse off as a result of abolition, and £2.50 a year better off if he had been buying 4-monthly licences. It has been suggested that in some rural areas (eg. the Highlands of Scotland) road conditions are such that rural motorists get worse rather than better average fuel consumption. At 25 mpg and 9700 miles a year a motorist would be between £20 and £25 a year worse off as a result of abolition.

6. These figures assume no change in the fuel efficiency of vehicles used by rural motorists. But higher petrol prices could give an incentive to reduce fuel consumption and in the long term motorists, especially those who travel high mileages, could be expected to choose more economical vehicles. The lower paid, who tend to do a lower mileage than average, might also expect to benefit proportionately more.