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FROM : B J COCKERELL

DATE : 11 February 1988

APS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Financial Secretary
Miss Sinclair
Mr Michie
Mr Cropper
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Mr Forman

11 FEB 1988

CAR TAX : MEETING WITH SIR JEFFREY STERLING CBE

1. I attach a briefing note for the Economic Secretary's meeting with Sir Jeffrey Sterling on Friday 12 February.
2. Despite the reference in the Treasury's commissioning note dated 5 February, Motability do not manufacture vehicles for the disabled.
3. I shall attend with Mr Hamilton (Principal responsible for car tax) and with Mr Monk (Principal in charge of VAT reliefs for the disabled) to support the Minister.

B J COCKERELL

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Internal distribution

CPS	Ms Barrett
Mr Knox	Mr Green
Mr Jefferson Smith	Mr Hamilton

MOTABILITY : CAR TAX RELIEF FOR LEASED VEHICLES

MEETING WITH SIR JEFFREY STERLING : 12 FEBRUARY 1988

1. Background

Motability is an independent charitable organisation formed in 1977 by a group of prominent people at the suggestion of the Secretary of State for Social Services and the then Minister for the Disabled. Its main objective is to enable people who receive mobility allowance to use it to lease (or hire purchase) a new standard production car, either as a driver or passenger. Cars are normally leased (or bought on hire-purchase) for a period of 3 to 4 years in exchange for the whole of the mobility allowance i.e. £22.10 per week at present, increasing to £23.05 in April. The mobility allowance is paid direct to Motability by the DHSS. The cars supplied may, where appropriate, be adapted for the needs of the disabled person. Motability negotiates special discounts with manufacturers and insurance brokers, and can arrange hire purchase where necessary.

2. Object of the meeting

Motability wish to put forward a proposal to relieve from car tax vehicles which they purchase for subsequent leasing to the disabled. They are not asking to discuss the tax position on vehicles which they sell by hire purchase but this may be addressed during the meeting.

3. Motability Scheme : operation and tax implications

Motability has two main ways of providing vehicles for the disabled:

- (a) Sale on hire-purchase, under which Motability buys the vehicles VAT and car tax paid from the manufacturers. The VAT paid to the manufacturers can be reclaimed as input tax by Motability but output tax is due (on vehicles not substantially and permanently adapted) on the subsequent sale by Motability to the disabled person. There is thus neither VAT nor car tax relief on such sales.

- (b) **Leasing**, where Motability buy the vehicles VAT and car tax paid and lease them to the disabled. The VAT is reclaimed in the normal way and, since the subsequent hire of the vehicles to the disabled is a zero-rated supply, VAT is effectively relieved. However, since car tax is a single-stage tax on the construction of a vehicle there is no provision for a parallel supply-oriented relief in respect of this tax.

In summary, there is neither VAT nor car tax relief for cars **purchased** by the disabled through the Scheme. For vehicles **hired** from Motability there is relief from VAT, but not for car tax.

4. **Motability reliefs : history**

- (a) **VAT Input Tax**. The normal VAT rule for cars is that input tax on cars purchased by a business for its own use is non-deductible (i.e. the business cannot reclaim the VAT on the cars it uses, though it can reclaim the VAT on cars it purchases for resale). However, since July 1979 Motability has been allowed to reclaim input tax on all cars it purchases whether for leasing or resale to persons on receipt of mobility allowance.
- (b) **VAT on Leasing Charge**. As with a normal business, Motability was initially required to charge VAT on its car sales and leases. However, since September 1984 the leasing charge has been relieved of VAT by taxing it at the zero rate.
- (c) **Car Tax relief**. As part of the Budget "lollipop" possibilities in 1984 and 1987, consideration was given to relieve from VAT and car tax cars used by recipients of mobility allowance and leased through the Motability scheme. As a result, the concession to allow VAT zero-rating of the leasing charge was granted in September 1984. After detailed examination, further reliefs were ruled out on grounds of cost and the danger of repercussions. A concession for Motability which extended to ordinary cars would be costly, difficult to control and would undermine the principle that tax "caring" reliefs should relate to identifiable goods and not to general goods obtained by particular recipients.

5. Other reliefs already available

- (a) Vehicle Excise Duty. Since December 1978 vehicles used exclusively for the purposes of a disabled person in receipt of mobility allowance are exempt from Vehicle Excise Duty (i.e. Road Fund Tax).
- (b) VAT and car tax on an adapted vehicle. A vehicle designed or substantially and permanently adapted for the carriage of a chronically sick or disabled person in his wheelchair or on a stretcher is eligible for relief from both taxes. This relief recognises the heavy additional costs that such a person has to bear to obtain a private motor vehicle which can fulfil this transport needs.
- (c) VAT and car tax on the cost of adapting a vehicle. The cost of adapting a vehicle to suit the requirements of a disabled person are relieved of VAT by zero-rating the supply. There is normally no car tax liability in respect of such adaptations since they are usually undertaken after the point at which car tax is charged.

6. The Motability case

Motability's case is set out in detail in their note dated February 1988, a copy of which is at Annex A.

Briefly, Motability's case is based on the benefits that further relief from taxation would bring in terms of effectively increasing the funding for the Scheme. This could be used to reduce initial payments and insurance costs as well as allowing more disabled people to avail themselves of the facility.

7. Arguments in favour

The adoption of the proposal would further appease the "disabled" lobby. It would help particularly those in receipt of mobility allowance to acquire the use of a car which had no adaptations or only minor modifications which did not qualify for the relief mentioned at paragraph 5 (b) above.

Arguments against

- (a) **Revenue.** This proposal has been considered and rejected in the past on the grounds, inter alia, of revenue loss. Based on the 1987 estimate of 17,500 vehicles supplied annually to Motability for leasing, the car tax (at an average of £423 per car) would be £7.4 million. If such relief generated a substantial increase in demand (as we would expect) the figure could be substantially higher - up to £17 million per annum if Motability were to be called upon to lease cars to its estimated capacity of 40,000 new vehicles each year. This loss of car tax would be permanent since unlike VAT (which is due when Motability sell a vehicle after a period of leasing), any relief from car tax will not be recouped at a later stage because it is a one stage tax collected when the vehicle is delivered from the manufacturer's premises.
- (b) **Control.** A concession on the lines sought by Motability would appreciably widen the scope for abuse and would present significant administrative and control problems. There would be nothing to prevent entitled persons leasing cars through the Motability Scheme free of car tax nominally for themselves, but in reality for their relatives and friends. Since there is no ability to recoup car tax on subsequent sales by Motability, there would be considerable control problems in ensuring that vehicles do not pass into private ownership after only a nominal leasing period. We would not welcome the extra administrative burden which this would impose in an area which would be very sensitive indeed to police.
- (c) **Repercussions.** This concession would heavily favour the Motability scheme and could lead to similar applications from other bodies which would be difficult to resist. Such an extension would increase further both the revenue loss and the control difficulties.

The proposal by Motability is seen as the thin end of the wedge. It would further increase the gap between the tax relief enjoyed by the leasing scheme as against the hire-purchase arrangement, and thus inevitably lead to a request for similar relief in the latter area. Not only would this be more costly in terms of lost revenue, but the scope for abuse would also increase; it could also lead to strong complaints from car dealers who would see their competitive position undercut.

- (d) Ancillary costs to the Exchequer. Motability's administrative responsibilities are funded by the DHSS. At present Motability lease vehicles to about 6% of the 539,600 people (as of December 1987) who receive mobility allowance. A substantial increase in demand for vehicles supplied by Motability could require additional funding from the DHSS to cover the increased administrative costs of additional staff, larger premises and improved computer facilities.
- (e) General. The scope and coverage of the VAT and car tax reliefs relating to the disabled have been considered very carefully on a number of occasions in response to pressure for an extension of relief. The limitation of complete relief to cars which are either designed or substantially and permanently adapted recognises the high cost of such adaptation to a person whose condition means that they require one of these specialised vehicles. To extend VAT and car tax relief to unmodified cars used by disabled people, or even to cars with less substantial adaptations, would be very costly and would be open to considerable abuse. It could also lead to pressure to extend relief to other general purpose goods used by the handicapped, particularly since many disabled persons do not wish to, or cannot afford to run a car, or are housebound because of the nature of their disability. We remain convinced that the best and most effective way to help the disabled is not by introducing wider and more costly indirect tax reliefs, but through the system of allowances which the disabled can spend in any way they choose.

9. Recommendation

Motability received generous concessions in 1984, and our strong recommendation must, once again, be against granting this further concession - both on revenue grounds and, more significantly, because of control problems and possible repercussions. A facility for Motability would undermine the principle that assistance for the disabled should allow the recipients freedom of choice as to how the relief may be used. The present proposal is of genuine advantage only to a handicapped person wishing to have the use of a car.

10. Suggested line to take

At this late stage in the run-up to the Budget, decisions on changes in car tax are a matter for the Chancellor's budget judgment. However, you may wish to acknowledge that Motability's views have been noted and that you will see that they are passed to the Chancellor.

Difference in concept between VAT and car tax

Car tax is a one-stage tax on the manufacture of a chargeable vehicle, and is collected at importation, or on first sale by the manufacturer (or franchised importer). Revenue control is based on the DVLC registration/licencing procedure, and once registered for road use there is little subsequent control apart from chance 'sighting' reports (usually of 'converted' vehicles) by Customs and Excise local staff.

There is no tax-free ring for car tax, nor is there any subsequent charge to car tax on disposals once the car has first passed the car tax tax-point. Thus there is no mechanism by which car tax can be recouped (possibly on a second-hand selling price) after a period of leasing has taken place - such as by Motability to a disabled person.

VAT is a multi-stage tax, and it is possible to recoup tax on a later supply, even if VAT has been relieved on earlier transactions involving the same vehicle.

It is this basic conceptual difference between the two taxes which can sometimes prevent the treatment for one exactly mirroring the treatment for the other.