Institute for European Environmental Policy

EHS Case study: Company cars use as fringe benefit

A Summary

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Company car – private use taxation

- It is the largest category of fringe benefit in the EU.
- The subsidy impacts on purchase choice for larger cars - mostly diesel.
- There are successful cases of reform (e.g. UK).
- There are calls for reform.
- Inconsistent with European cars and CO2 policy and with environmental policies/taxes.

The type of subsidy in the NL

On-budget subsidy to consumption - **use of company cars by employees for private purposes:**

- **The fringe benefit is taxed at a rate (half of) optimal level** (the optimal level would be 51% of the car's value; the actual level is 25).
- **Commuting does not count as private use.**
- **Exemption from VAT for purchase, repairs and fuel**, if paid by the employer
- **Free fuel** (even for private trips).

The subsidy size

Subsidy size:

- Counterfacutal = company car private use **taxed on the basis of the net costs of owning a car** (excluding costs of business use) = 8,700EUR year net costs
- Emloyees pay taxes on 4,250 EUR (25% of book value of the car) **– almost half of the cost of owning a car**
- The annual subsidy is **2,6 billion EUR/year** in the NL
- In the EU estimated to be **18 billion EUR / year** in deadweight lossess (G&O, 2009)

The environmental impact

Environmental impact:

- There are more cars than there would be otherwise
- Company cars are larger (by about 9,000 – 12,000 EUR)
- Additional travel for commuting significant +7,100km/year   (Graus W., 2008) = 0,9 Mtons CO2/ year

The subsidy is environmentally harmful **and leaks from intended recipient (business and economy) to high income professionals and car manufacturers.**

Integrated assessment results

Is the objective still valid?

- Promote productivity / de-tax business
- 90% company cars are not or hardly used for business purposes.
- Professionals prefer cash or relocation benefits.

Cost-effectiveness:

- Directly targeted policies / tax exemptions to businesses are more effective
- Removal would increase cost-effectiveness of other instruments e.g. road pricing

Incidental impacts:

- The most inequitable fringe benefit (COWI, 2004) – high income, men
- Increase commuting distances, larger cars, more cars per household

Integrated assessment results

Policy reform:

- **Subsidy removal:** US model - additional wage that can be used to lease a car if needed; employee pays taxes on full cost; de-taxed reimbursement for use for business purposes.
- **Wider graduated tax rate ranges**– in UK 70% employers opted out of cc scheme
- **Benefit tax on free fuel** (good results in UK reduction of 70 Mmiles; in Sweden -20% in private mileage)
- Commuting needs to be accounted as private mileage

Negative impacts

- Need to carefully avoid leakage to other systems

1. There are **no significant trade-offs** between objectives and impacts.
2. The **removal of subsidy would increase cost-effectives** of other environmentally friendly policies.
3. There are **available and successful policy reform options**.

Assessment of tools

- The tools provide excellent structure for the analysis
- Provide some basic facts even in a ‘light’ approach
- Need some expert judgement (e.g. to define credible counterfactual)
- Need literature (existing micro-economic studies)
- Need a further assessment of reform options
- To estimate size of environmental impact need use of model.

Thank you!

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Summary of results

- Substantial taxes foregone
- Impact on commuting distances, larger cars, number of cars
- Equity issues
- Only for a small proportion (22%) company cars are used for business purposes – however businesses enjoy some tax-free labour compensation
- It is a very indirect subsidy – better to subsidies businesses' productivity in other ways
- Other compensation measures are preferred by employees
- There are existing successful policy alternatives

Questions?

- Is it more desirable to promote the removal of the tax distortion (increasing it to the optimal level – in this case from 25% to 51%) or greening of the company cars tax incentives through stronger tax rates differentiation on the basis of CO2 performance?