The Potential for Further Changes to the Personal Taxation Regime to Encourage Modal Shift

Stage 1 Report Government Seminar

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Draft Report: Overview

The report contains a review of UK and overseas experience in using the taxation system to encourage more sustainable modes of transport for commuting.

There is a review of the UK tax treatment of commuting benefits, which is compared to those of other countries with a different tax regime. This concludes that:

- A general tax concession for all commuting trips creates negative transport and environmental impacts; it tends to stimulate car commuting and trip lengthening and is costly to the state concerned.

- In countries with a similar tax treatment of commuting as exists in the UK, targeted tax concessions upon employer-provided Travel Plan benefits have featured. These have been intended to support the development of effective travel plans and stimulate the use of measures that have proven to be effective in influencing modal shift. Such an approach could also be incorporated into an advanced fiscal/environmental strategy whereby tax reductions are targeted to support policy objectives.

A detailed review of the costs of three types of tax concession and likely modal shift effects is summarised as follows:

Measure	Tax and NIC Cost	Modal Shift Effect
A general tax and NICs concession on public transport season tickets	£576m per annum	Raise public transport use by about 7%; cut car use by about 3%
A capped (de minimis) £500 pa concession on public transport season tickets	£201m per annum	Raise public transport use by about 10%; cut car use by about 5%
Employer-provided Travel Vouchers to a NICs and tax-free value of £500pa	£27 - £100m depending on rate of uptake	Raise public transport use by 20-37% and cut solo car use by 8-20%

A survey of employers developing Travel Plans led to the conclusions that:

- In some cases, although information and guidance may appear an appropriate response, their impact would be limited without being spearheaded by actual tax reform. This particularly applies to addressing the reluctance of employers to offer tax-liable Travel Plan measures due to the deep-seated culture of ‘tax-efficient’ staff benefits.

- The issue of tax and clashes with a company’s ‘tax-efficient’ culture is of most significance when organisations are trying to develop their Travel Plans from their initial, fairly ineffective stages, to be more effective by the use of financial incentives and disincentives.

- There is evidence that tax does reduce the effectiveness of Travel Plan measures and that some modest and targeted reform measures could both eliminate most of the negative tax impacts and ease the development of Travel Plans within a company’s dominant culture.

Overall it is suggested that a double test be adopted for considering further Travel Plan tax reforms. One would be an essentially quantitative evaluation of cost per car trip averted or per unit of emissions reduced.

The second test would be qualitative, but would systematically recognise that there are some tax concession actions that could enhance the public acceptance of difficult but necessary transport policy measures and also act as an insurance policy against the Government being forced into expensive, politically embarrassing and counterproductive actions.

Personal Taxation and Transport Policy

- Commuting is not tax deductible in Britain

- Employer-provided commuting benefits in kind are taxed, with the major exceptions of:

    - Car, bicycle and motorcycle parking
    - Contract bus services
    - Interest free loans to buy tickets, bikes, cars or houses
    - Backup ‘get-you-home’ services for car sharers
    - Bicycles

- Public transport tickets and other commuting benefits in kind are subject to tax and employee NICs. From this year, Employer NICs are also charged on employer-provided benefits.

Other Countries’ Tax Regimes

The report contains a detailed examination of the treatment of commuting expenses in other countries, particularly Germany, the Netherlands, the USA and Ireland. This concludes that:

- A general tax concession for all commuting trips creates negative transport and environmental impacts; it tends to stimulate car commuting and trip lengthening and is costly to the state concerned.

- It is possible to focus a general tax concession upon public transport commuting trips. It can be politically difficult to reduce car commuting benefits, and in many cases may be prejudicial to the greenest mode of short walk and cycle trips. Such a policy can still contribute to trip lengthening. To be effective, such reforms may require a complex system of allowances, as in the Netherlands.

- The Dutch example of simplifying the commuting concession to more sustainable modes as part of a general tax reduction strategy indicates an advanced level of fiscal/environmental policy integration. As part of such a strategy, the concept of tax loss becomes irrelevant.

- In countries with a similar tax treatment of commuting as exists in the UK, targeted tax concessions upon employer-provided Travel Plan benefits have featured. These have been intended to support the development of effective travel plans and stimulate the use of measures that have proven to be effective in influencing modal shift. Such an approach could also be incorporated into an advanced fiscal/environmental strategy whereby tax reductions are targeted to support policy objectives.

Modal Shift Effect of Tax Concessions

A detailed review of the costs of three types of tax concession and likely modal shift effects is summarised as follows:

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A capped (de minimis) £500 pa concession on public transport season tickets	£201m per annum	Raise public transport use by about 10%; cut car use by about 5%
Employer-provided Travel Vouchers to a NICs and tax-free value of £500pa	£27 - £100m depending on rate of uptake	Raise public transport use by 20-37% and cut solo car use by 8-20%

Key Conclusions

- A general tax concession on public transport season appears to be relatively ineffective in terms of modal shift, would have negative equity effects and could produce some serious adverse transport and environmental impacts.

- A £500 pa tax free allowance would reduce the annual tax cost to an estimated £207m, compared to £576 for an uncapped concession and would address the equity and adverse transport impacts of an uncapped allowance.

- The use of tax-exempt employer-provided public transport benefits would be expected to achieve a good modal shift impact – a reduction in single occupancy car commuting within the range 8% - 16%, and up to 20% in the long term (25 years).

- Employer tax incentives to promote employee public transport benefits significantly increases the use of this measure

Employee survey results with UK employers

- Work for the Scottish Executive confirms the results of empirical studies in the Netherlands and USA that direct incentives and disincentives (particularly used together) are the most effective Travel Plan measures.

- Bowden’s work lacked the empirical verification of the Scottish Executive study. However it clearly identified that price is the key factor for attracting car users to public transport. This is because, compared to the car, public transport lacks an advantage in other key factors.

- Root’s work indicates the need for any tax reform to be integrated with Travel Plan strategy – in particular the need to provide for flexible, occasional use of public transport (‘Travel Blending’). A season ticket tax concession would not fulfil such a role, whereas a Travel Voucher scheme would.

- Overall, employee interviews confirm the results of empirical studies that a reduction in single-car occupancy car commuting can be achieved by the use of financial incentives and disincentives. The effect ranges from about 5% to 20% depending on the mix of measures adopted, timescale and the situation of the individual Travel Plan.

Employer Survey

The survey aimed to:

- Document employer provided support for employee commuting;
- Identify what modal choice was available to employees;
- Assess what evidence is available on the effects of taxation on work journey modal choice;
- Identify any impacts of the 1999 Budget changes;
- Identify and explore analogous situations to tax reforms and situations where there has been a change in the tax treatment of commuting benefits and where ‘before and after’ information is available.

The aim was be to obtain at least 30-40 good responses representing a balanced mix of:

- City Centre, Suburban, Urban Fringe and Rural locations
- SMEs and large employers
- Service, manufacturing and public sector employers

The intention was not to provide a statistically representative sample, but to have sufficient interviews to cover the broad range of circumstances in which Travel Plans are developed.

Employer Survey Results

Employer's view of the most effective Travel Plan measures

This depended on the experience of the employer.

- Discounted public transport passes (12)
- Subsidised Public Transport Fares (2)
- Improving local bus services (6)
- Car Parking Charges (6)
- Contract bus services (4)
- Car Sharing (3)
- Parking Permit Restriction (2)
- Parking Permit allocation/Carshare (1)
- Cashout of Car Parking (1)
- Bicycle Facilities (2)

Use of Tax-liable Measures

- With certain significant exceptions, such as contract buses, in general, tax-liable measures tended to be more costly to companies than non-tax liable measures and the issue of cost came before tax issues.

- There seemed to be no real awareness of the effectiveness of such measures.

- Some employers were very uncertain about what measures were and were not tax-liable

- Overall, once tax was raised as an issue it opened up a variety of issues.

The 'tax efficient' Culture

Employers have a 'tax efficient' culture and it is very hard to argue the case for staff remuneration that will increase tax payments. The whole ethos is to reduce tax costs. This thus puts a mind frame against taxable Travel Plan measures and makes it very difficult for them to be adopted.

That Travel Plans are not a core activity or a core part of staff benefits only reinforces this situation.

For example, M&S '*automatically assumed that measures that attracted tax were important to avoid because tax implications were to be avoided.*'

In some cases this led to badly designed Travel Plan measures, simply to avoid tax.

Tax Effects upon Travel Plans - Discussion

The Nature of the Taxation problem

The evidence from our employers’ survey indicates a wide variety of issues that require careful consideration, in particular to what extent is a reform to the tax regime an appropriate response to the problems and issues raised. The issues raised in the survey could be grouped into five types of problems and responses as shown below:

Travel Plan Tax Problems and Appropriate Responses

Problem	**Appropriate policy response**
1. Confusion about the impacts of the tax system	Information and guidance
2. Aversion by employers to certain tax-liable measures that are, nonetheless, cost-effective to companies	Information and guidance??
3. Costly and clumsy administration	Reform the administration of tax gathering
4. Uncertainty of liability to taxation on Travel Plan measures	Reform to the tax/NICs regime to remove ‘grey’ areas
5. The tax system makes certain tax-liable measures costly to implement and reduce their effectiveness	Reform to the tax/NICs regime

A reform to the tax/NICs system is not the only, or most appropriate response to a problem with the tax system adversely affecting Travel Plan measures. In our survey there was a mix of these problems. Some just related to confusion and uncertainty over the entire tax impacts upon Travel Plan measures. Although tax concessions might raise confidence, the main problem here is one that information and guidance would address.

A separate issue is the issue of uncertainty to liability to taxation. This was a major issue in our previous 1998 study and was the major issue addressed by the 1999 Budget reforms. This concerns the ‘grey’ area where a local tax office may or may not view a technically taxable benefit as worthy of their attention. Although the 1999 Budget cleared many grey areas, others remain or appear to have emerged.

Costly and clumsy administration has been the subject of a previous reform to the gathering of taxation revenue. For example, the use of PAYE Settlement Agreements for an employer to pay tax and NICs on behalf of their employees for a taxable Travel Plan benefit.

The aversion by employers to certain tax-liable measures is an issue that may, or may not require a tax reform approach. The survey provides strong evidence that this cultural aversion to tax-liable staff benefits is deeply rooted. Should this be taken as a part of our company culture or should it be challenged?

If the problem is essentially that this tax efficient culture is resulting in the avoidance of Travel Plan measures that are, even allowing for tax impacts, cost-effective to companies, then it would appear that information and guidance is the most appropriate response. However, is this aspect of company culture just too deeply entrenched, so making an information and guidance response a pointless exercise?

There is a distinction between this problem of aversion to tax-liable measures and problems where the tax system actually makes certain Travel Plan measures costly to implement and reduces their effectiveness. The latter certainly requires a consideration of tax reform. However, in practice tax reform may be the only way to effectively address both these groups of issues. This certainly appears to be the understanding behind the approaches to reforming taxation to support Travel Plan measures in the USA, Ireland and the Netherlands.

Cost Effectiveness and Value for Money

- If further changes to the personal tax regime to support the development of Travel Plans are an appropriate response, then how should these measures be evaluated? Some procedure is required to evaluate the benefits achieved against the tax cost to the Exchequer.

- Formal Cost Benefit Analysis is not necessarily the most useful approach. For example, in Canada, this has not advanced the case for tax exempt transit benefits and advocates and Revenue Canada seem not to understand each other.

A dual-level approach seems appropriate:

Level 1: Cost per Environmental impact reduced

At the level of the individual tax concession, a target-led approach would provide focus to evaluating alternative policy mechanisms. This requires an agreement as to the indicator used. In the context of Travel Plans, reduction in single car occupancy trips seems an appropriate indicator. This is a travel behaviour indicator. Alternatively, an environmental impact indicator could be used, measuring the result of the changes in travel behaviour. The reduction in emissions of local air pollutants and CO_2 reduced might be such an indicator.

Drawing upon Root's figures, from the previous section, which assumed a moderate takeup of a Travel Voucher benefit, the estimated effect was that there would be a tax cost to the Exchequer of £27m associated with 480,000 employees using Travel Vouchers. Assuming 20% of these to involve modal shift, then the Exchequer cost of £27m pa divided between the 96,000 modal shifters comes out at £281 per annum. At about 230 round commuting trips a year, this would come out at about a cost to the Exchequer of £1.22p per round car trip diverted.

Level 2 - Policy Synergy

There is a fundamental problem with evaluating a policy instrument in isolation. This stems the nature of fiscal instruments to achieve transport and environmental policy objectives. In all studies on this subject, emphasis is laid on the need for a synergistic package of measures. These involve a variety of approaches, regulatory, direct government action, information programmes and economic instruments. The crucial point is that individual instruments on their own may only have limited benefits. In such circumstances, an assessment of each instrument alone may reject them, but together they are cost-effective.

At the more strategic level, tax exemption for more sustainable forms of travel are one form of government action that address frequently voice demands for appropriate 'carrots' in transport policy. Transport is a notoriously difficult policy area, and one where it is increasingly recognised that any effective action involves controversy to some degree or another.

A tax concession on more sustainable transport behaviour, to both new and existing users, would play an important role in raising the acceptability of other transport measures (fiscal or regulatory) in the Government's programme.

The current situation over petrol prices is just one such example, with a campaign for a 2p/litre cut in fuel duty that would cost the Exchequer a billion pounds. There is a real danger that the Chancellor could be pushed into conceding a cut in duty on fuel that would reduce Treasury revenues far more than a well designed measure on more sustainable modes. A premptive tax concession on sustainable commuting initiatives costing £100m would put the Government in a good position to resist demands for a £1,000m cut in fuel duty that would yield negative effects upon transport and environmental policies.