The long-term options for the taxation of vehicles

General Features | Indirect Tax



26 May 2023

As the government grapples with the long-term options for taxing vehicles, we consider some of the key factors.

One of the hot topics in taxation is what we should do to replace fuel duty. The Office for Budget Responsibility estimates that fuel duty will raise £24.3 billion in 2023-24, which reflects the two-year cut of 5p per litre implemented for 2022-23 and 2023-24. Total taxes are estimated at £950.5 billion – so fuel duty is just some 2.5% of total taxation. Yet replacing fuel duty with other taxes would mean increasing the basic rate of income tax by at least 4%, taking it to 24%; alternatively, it would mean putting up VAT to 23.5%. (HMRC estimates that 1p on the basic rate would raise about £5.6 billion in 2023-24 and 1% on standard VAT brings in £7.35 billion – see tinyurl.com/22uz6bf7).

The average petrol car covers about 6,800 miles every year, meaning that the fuel duty and VAT amounts to some £685 a year for the average family car. Diesel cars

average around 9,400 miles annually, bringing in even more tax revenue. The RAC Foundation estimated in 2021 that a small car's mileage could cost about £525 per year, while a much larger car could cost about £900 in tax – or £1,100 if diesel (see tinyurl.com/5e9k67b8). Commercial vehicles have much higher costs, based on their higher mileage and fuel consumption.

Vehicle excise duty, charged for keeping a vehicle on the road, brings in about £8 billion annually. It is currently not charged on electric cars, although the Chancellor has signalled that it will be introduced at a low level from 2025. The rates are currently based on emissions.

The choices facing government

The tricky question for future governments will revolve around its desired long-term means of taxing vehicle use, as well as managing the significant transition. Even if new petrol/diesel cars are not sold after 2030, existing ones are likely to continue in use for some years. Governments will need to consider incentives to move away from petrol/diesel to greener power, too.

Our current system of vehicle taxation charges tax on the purchase price (VAT) and road use of a new vehicle (vehicle excise duty); and fuel duty and VAT on the mileage. In certain areas, congestion charges apply, as well as charges for higher emission vehicles. Tolls are levied for using specific routes (typically bridges and tunnels, although there are road tolls as well).

The choice facing governments is whether to keep this system, or whether instead to raise greater amounts of money in general taxation. The transition may well require raising general taxation, if it is considered that incentives to purchase electric vehicles are still needed.

If we assume that the long term state is that some tax at least should be raised from road users, the question is whether to change the structure of the taxes levied.

I would suggest that congestion and emissions charges and tolls are best kept for their specific purpose: to reduce congestion and emissions through financial incentives and to charge for the use of key infrastructure. In 2021-22, London's congestion charge net revenues reached £307 million, while its Ultra Low and Low Emission Zones generated a net income of £111 million and £34 million. Building

road pricing management systems around the whole of the UK would be impossibly expensive; the huge number of cameras and supporting technology needed is surely best kept focused on small, specific areas.

Charging for road mileage

The bigger question is how to charge road users for their mileage. I would suggest that requiring power companies to levy charges when users charge their vehicles is probably the best answer. There are a manageable number of power suppliers, similar in concept to the relatively small number of fuel suppliers. They can manage collection of tax from their customers – which is part of the fundamental design of most taxes. Electricity suppliers currently offer specific pricing for electric car home charging packages, demonstrating that they can identify differing home use of electricity. Obviously, public charging stations can do the same. It is estimated that there are currently about 400,000 home chargers, as well as over 42,500 public chargers in 25,000 locations (see tinyurl.com/4ebx3sfe).

The other alternative seems to be fitting a monitoring device to every vehicle. It would be possible to monitor exactly where a vehicle went and at what times, so it could be used to charge differing amounts based on specific types of use. However – and leaving aside the privacy question – the problem is who would manage the system. Levying charges individually on the UK's 40 million vehicles (see tinyurl.com/5apz783b), including 33 million cars, would be an almost impossible task, open to massive fraud and collection difficulties.

It is surely time for greater public understanding of the future for vehicle taxes, accompanied by a range of modelling to highlight the impacts.

© Getty images/iStockphoto