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Rt Hon Gordon Brown MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

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BUDGET 2005

The UK's automotive and motoring businesses are wary of the immediate outlook for the sectors. Firm economic growth and low inflation in the recent past had helped us grapple with major changes and restructuring in our markets. Yet rising cost pressures, the prospect of softer demand ahead and on-going reworking of all motoring taxes are testing our members' competitiveness. We see that 2005 is not the year to unveil any unexpected or new regulator burdens on business. On-going dialogue with government and our voluntary lead on initiatives to enhance competitiveness and influence both consumers' and businesses' appropriate choice and use of vehicles is the route to take.

Businesses continue to accommodated extra regulatory costs and new environmentally-inspired taxes and incentives are making impacts on our choice of vehicles and transport use. We urge government to seek efficiencies in its own operations and set appropriate targets on the expectation placed on business and the motoring sectors.

I enclose more detailed comments on the outlook for our members' businesses, the areas where we continue to be engaged with government and others and priorities and comments on key policy aspects affecting our sector that are currently under consideration. If you would like to discuss these, please do not hesitate to contact me.

I and my colleagues look forward to continuing our dialogue on these issues.

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Chief Executive

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BUDGET 2005 – March 2005

1 The automotive manufacturing outlook remains challenging. Increases in key input costs along the supply chain and tight labour markets put pressure on the cost base. Subdued demand in key European markets mean uncertainties on sales and profitability, while exchange rate realignments still raise issues in other global markets. In the UK too car sales volumes are softening, albeit from a very robust base; CV sales growth appears firm, again at very robust volumes. UK assembly volume remains healthy and stable, but business fortunes are mixed below this surface calm. For both commercial and private motorists too there is some unease, with mixed expectations on the shape and costs of motoring ahead. The recent rises in fuel costs, significant rises in aspects of services costs, especially for motoring costs and reworking of all motoring taxes are key factors here as is wariness on the future shape of road pricing and congestion charging.

2 In this context the government's commitment to promoting domestic economic stability has been of great benefit and many aspects of the 2004 Budget and Pre Budget Reports were also appropriate for our sector. Overall the approach signals stability, with some understanding on business and personal taxes and costs that have seen fundamental changes in recent years. We hope that this direction and assessment will be kept in Budget 2005. More open review, dialogue and understanding on what is being achieved and what are appropriate, fair and realistic expectations for the years ahead is the right route. Unexpected and poorly designed taxes on business and motorists will only erode confidence and competitiveness. And in our sector the key stakeholders are truly global.

On-going dialogue on taxation and engagement on competitiveness and environment

3 SMMT member businesses value the on-going dialogue and contact with ministers and officials on our business and related motoring interests. Our healthy exchange of views and expertise is necessary. We may not agree on the final policy decision, but it is valuable to explain and debate our members concerns. We want to see taxes and incentives well-designed, technically feasible, appropriately targeted and meeting aims with fairness, simplicity and transparently. Our members are also very keen to see rigorous monitoring and review of new environmentally inspired policy. We look forward to further reports on the impact of the new structure for company car tax and a review of the changes to car, van and lorry VED.

4 Our members are fully engaged and working towards common goals on a wide range of commercial and environmental aims. Balancing the challenges of global competitiveness, sustainable growth, social and environmental responsibility and the development of multiple routes to help achieve a low carbon economy is a very big task. Through the Industry Forum, Automotive Academy, management of the Foresight

Vehicle Programme and in the Low Carbon Vehicle Partnership, SMMT member companies are focused on these challenges and actively at work. SMMT has also led in its annual reporting on 'sustainability' amongst its signatory members in the UK and on CO_2 emissions from UK new cars. These show a consistently prudent and improving use of resources in our sector and sustained improvement in the average and mix of lower CO_2 emission new cars sold. Our recent response to the UK Climate Change Review process distils our current actions and thinking. In the long run we believe that new and innovative technology will be effective, but in the meantime we see a need for appropriate targets for transport that engage all stakeholders and with government providing stable and durable frameworks for collective action. One of the key challenges we foresee is that of restructuring and supplementing current revenue streams of motoring and environmental tax while retaining revenue neutrality.

Company car and van taxation

5 The company car market is still a key one for most of our members. We are keen that government continues to review the effects of the major restructuring at 2002. No change in the scales from 2005/06 to 2006/07 is a relevant pause during which to consult on the next steps in this policy. During 2005 the minimum scale charge will be at the key 140g/km benchmark and the average tax rate should be near the 170 to 175g/km benchmarks. The minimum CO_2 rate at 2003/04 was 165g/km which means that a cut of about 15 per cent will have been set in the space of four years. We see it as appropriate to retain the 15 per cent/140g/km minimum rate into 2007/08.

6 The switch to diesel engines and change to cash and own car use have been core changes. Diesel has and will continue to have a very firm role in meeting CO_2 reduction targets so it may be appropriate to reconsider the case against diesel and the need for a supplement. The move to own car use is unlikely to have been a successful aspect of the restructuring as the cars used may not be as new or as CO_2 efficient. In the planning stage of this change it was said that there may be a net increase into company cars, but this has not yet happened. Government's own estimates suggest that company car recipient numbers are down by at least 20 per cent. An evaluation of cash for car, own car use for work and role of Authorised Mileage Payments is therefore also relevant.

7 Prior to the 2004 Pre Budget Report we suggested that consumers be given time to adapt to the removal of the waiver for Euro 4 diesel cars – ideally on a taper linked to the three year cycle typical for most new car buyers. We recognise that the new standard has been effective from January 2005 and government has decided that the full waiver continue only for such cars registered to 31 December 2005. If government cannot reconsider, we suggest that the waiver be extended to the end of the 2004/05 tax year.

8 Tax incentives for alternative fuelled vehicles are not as straightforward as those for petrol or diesel. If CO_2 is to become a universal benchmark it may be best to have an incentive strategy for low emission cars/vehicles. Support for non-conventional fuels

could then be relatively technology neutral. This may then be more simply related to the main CO_2 tax scale charges and appropriate decrements might help promote their case. Currently their niche role and market perceived status as intermediary technology with uncertain residual values means further review of buying incentives may be needed under the EST Powershift scheme to raise their acceptance as company cars. This scheme has to be reconsidered and relaunched in 2005 so this may be another opportunity for a more stable and integrated support framework for low emitting vehicles.

9 At the end of February HM Customs & Excise launched an informal consultation on realigning the VAT fuel charge system to one based on CO_2 emissions rating. Although a view was not sought from SMMT, our initial reaction is that the detailed use of the company car structure is highly inappropriate, possibly unwieldy and over complicated. A more relevant base for consultation is the CO_2 aspect of the industry's current voluntary consumer label, which is based on the current six VED bands. We see the core issue here is for a fair and commercial value for VAT to be collected simply and effectively. Policy on private fuel use in company cars was to positively discourage take-up. It appears to have worked. The value was recast at £14,400 at 2003 and a scale charge related to company car percentage CO_2 ratings. The value has not been changed, and given the high starting base and trends in fuel prices it does not need to be increased further.

10 While the private use of company cars by employees is subject to the incentives and disincentives of CO_2 ratings those used by the self-employed are not. If government wishes to send consistent signals to all business car users where there is private use this is an aspect of the overall business car market that should be looked at.

11 The reforms and phased introduction on company van taxation is welcome. It is a positive approach to recognise the nominal benefit for most van drivers and from April 2005 remove the liability to any private benefit tax for those who have to take their van home. For those who choose 'unrestricted' private use there is a clear increase in benefit value at April 2007 to the average for a typical company car driver. The principles are straightforward, but much could still rest on technical aspects in published guidance and compliance audits on what constitutes 'incidental' and 'unrestricted' private use. If sensibly applied and checked this should be a successful deregulation.

Fuel duties

12 Postponing the inflation-based revalorisation of road fuel duties in 2004 was appropriate, as it was in 2003. The rapid rise and volatility in global crude oil prices means that the context was uncertain and so it remains. There may now be a good case for a more direct and transparent link for this annual decision to the state of the global oil market and other factors rather than the present ad hoc discretionary basis. Clearly fuel duties increases still retain a strong role in emissions reduction targets and funding the cost of public services, also business has to plan on the basis that it is the government's

intention to retain this role and see fuel duties rise at least in line with inflation. However, discretionary decision that return to above inflation increases will be unexpected and damaging to business, especially in the current cost context.

13 Industry still awaits a statement on government's commitment to a fuel duty incentive for zero sulphur fuels. SMMT recognises the government's generally positive support and commitment to the introduction of cleaner fuels and the probability of an incentive when market conditions are right, but early guidance and a stable time frame is necessary. This will assist in speedier application of cleaner engine technology to new cars and with widespread availability the environmental benefits will accrue quicker.

Fuels duty differentials – alternative fuels

14 SMMT's members value the support and incentives government provides by assisting the use of alternative fuels. This has an important role in research and application of competing low emission engine and fuel technologies. The statement on Alternative Fuels Framework (PBR 2003) gives some guidance and certainty over support to 2007 in this varied and commercially difficult market. It was necessary as incentives and expectation on their durability do influence decisions. The guarantee of stable duty incentives for biodiesel and bioethanol was well received, but the taper in duty support for LPG represents a tougher challenge for some businesses. While this has been deferred, it is unlikely to be a permanent deferral and the effects that the planned changes have should be monitored as should complementary policy to simplify discounts for low emission cars in the company car tax regime. Further evaluation of policy developments along the lines of a possible Renewable Transport Fuel Obligation (RTFO) and using biomass in conventional fuel production should also assist the difficult commercial context for such fuels. Overall, government's firm general support in aiding the commercial development and acceptance of such fuels is recognised by industry.

VED

15 Stable VED structures and rates for all cars, vans and trucks continue to be other welcome aspects of the 2004 Budget and Pre Budget Reports. SMMT members see that evaluation of the effects of these new approaches, first introduced in 2001, must be a perquisite to further change. To revalorising such a new and novel basis to the annual vehicle registration tax would be misplaced. The achievements must be assessed and a dialogue opened on aims and expectations from VED in the years ahead.

16 SMMT members believe that for the immediate future no further change to VED is necessary. We have systems that give positive and firm signal to motorists on the importance of weighing-up fuel efficiency and emissions ratings in their individual decisions on the most appropriate choice of vehicle for their needs. To enhance motorists' awareness of this our members, through their role in the LowCVP Passenger Car Working Group, are committed to renew the existing consumer information given to new car buyers. A colour-tagged labelling format, using the six A to F tags familiar on

electrical ‘white’ goods should be an effective aid to informed consumer choice and will be in general use from July 2005. SMMT is aware that this could be reinforced though the current six VED labels (AAA to D) by a reformat to the A to F tags and colour coding. As the underlying CO_2 bandings are consistent it is possible and will avoid any confusion amongst motorists. SMMT would support government if this were done and so urge an assessment of the practical issues involved as our voluntary initiative has the potential to be a role model EC-wide.

17 The changed basis to VED, with the central role of CO_2 emission ratings, put the UK in the lead on this policy in the Europe. With the EC currently evaluating proposals for member states to place greater emphasis on annual road and fuel taxes and that road taxes on cars should be linked to CO_2 emissions, the UK is well positioned to lead by example. SMMT is keen to see that the UK’s experience is appreciated and applied to the development of a relevant, consistent and workable EC-wide scheme. We look forward to being consulted and involved with this policy as it develops.

DVLA and fees

18 We are concerned by the wholly fee based stance the DVLA appears to be taking to meet its role for new initiatives on safety, crime and more robust motorist and vehicle tracking. The approaches outlined in the recent consultation all seek additional resources from motorists. We would have expected to have seen some other additional funding streams and improved productivity gains to be included. Businesses in the private sector have to adapt to demand for online services, provide added value to their customers and respond to more administrative and compliance costs from new legislation and self-compliance and assessment initiatives. We should expect no different from DVLA and are not convinced that this is a fair deal for motorists. The introduction of an annual registration fee – tagged to VED – is a concern both in principle and on future increases.

19 At November 2004 we sent our response to DVLA’s fee proposals consultation.

Lorry Road User Charging, EUETS, ELV, R&D Tax Credits

20 Lorry Road User Charging, the Climate Change Levy’s extension into the EU Emissions Trading System, Tax Credits for Research and Development and the shape of the implementation of the ELV directive post 2007 are other key policies that affect a wide range of businesses across the automotive spectrum. For many of our members some of these have developed into planning, technical or operational facets of their businesses, but on some there remain key principles to be resolved.

21 SMMT was concerned that the uncertainty and administrative burdens associated with the introduction of the EU Emissions Trading Scheme would tarnish the competitive record of UK production facilities. Delay and uncertainty remains over the National Allocation Plan, but on the whole our members in Climate Change Agreement see the content as appropriate. Sites not covered by the CCA have some very specific issues

regarding the ‘inclusion’ in the ‘engineering and vehicles – non CCA’ sector of the two new generators which effectively take fifty per cent of the sectors allocations, leaving the remainder with impossible targets to achieve. And as to phase two development, we see a real need to take stock and evaluate before moving on to include other areas, in particular surface transport. Looking forward, there is uncertainty over the role of CCA within the mandatory EU ETS phase two and beyond.

22 We are keen to re-engage with government on the application of the R&D Tax Credits to take stock of the practical experience in administering the policy. While we have not had recent feedback from our members, this may be due to commercial sensitivities in the specific application of the rules company by company, site by site. Where officials and members feel that there are common issues that could be usefully aired in open forum we are always ready to take them forward. Improvements to the definition and range of qualifying costs and materials consumed were seen as a positive step. Our members also welcomed the enabling delivery of the credit that officials were aiming for. We now need to check that it is working and whether there is scope for enhancement of the basic rate.

23 SMMT remains concerned by the commercial disadvantage domestic hauliers incur through high fuel duties in the UK. We are working with government and other stakeholders to add our experience to realise a fair and workable distance based charging system. Our overarching concern is that the specification chosen is interoperable with current in-situ telematic packages and other charging systems being developed elsewhere in Europe. For simplicity the technology employed must be consistent across all chargeable trucks. There will be issues in measuring and differentiating by user, vehicle type, age, specification and process for fuel duty reimbursement. We are covering these in our comments on January 2005’s discussion paper from the Department of Transport. We also see that while work in progress on LRUC continues government should consider other measures that could provide some redress before the full scheme becomes operational. The recent discretionary waivers on the fuel duty inflation revalorisation have helped, but there is natural concern over the immediate years ahead.

24 Given the unfavourable business cost context SMMT members are understandably cautious on developments here, but they are ready to respond positively to any new aspects that may be presented in the 2005 Budget.

Road pricing and user charges and transport taxation – the future

25 Road pricing and the spread of congestion charging are clear recommendations in policies to manage the envisaged growth in road traffic to 2025 and ration peak use of the road capacity. SMMT has been represented on the road pricing feasibility study group and our members recognise the need for action, but for complementary approaches to better road use. As businesses and motorists we are concerned that disjointed action will

add to costs that may be rising on a number of fronts and with no commensurate tax-led cost reductions. This may be bad for business, motoring and ultimately competitiveness.

26 There are key conflicts that remain unresolved such as those between tax hypothecation or not, raising revenue or neutrality, simplicity or complexity and fairness against universality. The challenge is to restructure the tax bases we have and supplement them with new more focused user and use based instruments while defining and achieving revenue neutrality. But, businesses and motorists are generally sceptical and ill-prepared for a generic and national strategy on road pricing and user charging. Scheme by scheme evaluation is an appropriate way forward, but it needs a transparent and consistent set of guidelines to provide effective national glue. The tax-take from motoring is already high in the UK, approaching £45bn a year, restructuring while remaining revenue neutral is the challenge we must accept. Again SMMT members will be keen to see how this debate and dialogue is taken forward Budget 2005.

Technical tax issues

27 Technical tax aspects of general business taxes and areas specifically automotive continue to presented concerns and compliance challenges to SMMT members. Business believes that we should aim for a fair, clear and commercially relevant tax regime with as 'light' a compliance process as is practically and legally possible. We recognise that the framework is an evolutionary one and often far from straightforward, but we welcome recent changes that aim to simplify and modernise the UK regime and take account of consistency within the EC. Our comments, concerns and regular dialogue have always found a receptive hearing, if not always been satisfactorily resolved in discussion consultation with the government tax and policy officials.

28 The £12,000 cap on capital allowances for so called 'expensive' cars has been a longstanding concern to our members and we welcomed the opportunity to open some real debate for change and we hope removal in the recent round of reforms to Corporation Tax. We have recently submitted our comments on the items under review. To recap on our main themes we see it best to include cars in the plant and machinery 'general' pool, 'uncapped'. Straightforward, clear and certain rules are best. The removal of the disallowed relief on lease rentals, for that proportion of car leases on 'expensive' cars, would also be a very positive change. There are costs and complications if the reforms are to cover all businesses, but we consider that phasing and transitional arrangements may help. We are very cautions on a 'graduated' environmental aspect. We see this as best emphasised in current CO_2 grading structures in more direct car tax instruments. Building on 100 per cent first year allowances will be a more familiar and acceptable approach. We also highlight some related issues for vans and trucks.

29 A continuing issue that affects some members, and exposes the way UK tax structures must respond to market changes, is the current VAT treatment of so-called combination vans – purpose-built light vans that can carry goods and a crew with a

payload below 1t. These are deemed to be cars for VAT purposes and VAT recovery is blocked. This is a barrier to firms needing such vehicles and means that they may have to consider less appropriate and heavier alternatives. Manufacturers are clearly trying to meet a market need, but in a difficult tax context. Our members have been in extensive consultation and meetings with HMCE on this aspect of the 'VAT definition of a car', but the differences over the status of these van remains unresolved.

30 While SMMT broadly supports the modernisation of consumer credit under the Consumer Credit Bill, we are supporting an initiative to remove outdated voluntary termination clauses. If this cannot be achieved, the industry seeks an amendment to increase the liability of the debtor to three-quarters of the total value of the hire purchase agreement. This has the full support of other industry bodies. If the clauses remain, motor finance will continue to incur significant cost provisions for the abuse of this aspect of current consumer rights. These costs (currently estimated at £83 million per annum) from voluntary terminations, the added risk costs of hire purchase and impact on residual general values can be lifted and eased if this aspect of the current bill is removed.