The impact of company car taxation on economic welfare

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Introduction

• Company car: important fringe benefit
  – 12% of Dutch employees
  – 40% of all new cars in the Netherlands
  – European ‘average’

• Tax reasons for getting a company car
  – It is much cheaper to get a car through your employer than through the market due to distortionary taxation

• What is the welfare effect of the tax treatment of company cars?
Theory

- Theory of welfare effects of tax treatment of company cars
- Company cars hardly used for business
- Company car taxation mainly affects workers’ behaviour
  - Car expenditure of the household
    (e.g. value of the most expensive car in the household; number of cars)
  - Private travel
• Distortionary company car tax
  – Households use a company car, but are not willing to pay the full costs to produce this car

• Welfare loss = difference between willingness to pay and cost
• Tax authorities use a rule to value private use of company cars
  – For example, in the Netherlands:
    • Company car purchase costs: €17,000
    • Annual employer costs of company car: €8,700
    • Annual employee increase in taxable income: €3,700
    • Distortionary taxation!
Methodology

• Data of households for the Netherlands: we follow households over time (1995–2006)

• households with at least one car

• We focus on the value of the most expensive car in the household:
  – We analyse this value for households that have a company car in one year but not in another year
  – We control for changes in households over time (e.g. income)
Car value

- When a household has a company car: car value: €20,101
- When the same household has no company car: car value: €8,964
- Company car taxation induces overconsumption of cars
- Annual welfare loss: €600 per company car
Private travel behaviour

- Due to taxation, company car drivers drive also more privately
  - Commuting distance: plus 14%
  - Weekend travel: plus 8%
  - During the week travel: no effects
  - Holidays travel: unknown

- Annual welfare loss: €180 per company car
Number of cars in the household

- Number of cars increases, but empirical results are difficult to interpret
- Ignored in welfare calculation
Welfare loss

• Annual welfare loss (car expenditure + private travel): €780 per company car

• We take into account other distortionary car taxation (e.g. purchase tax) and any other external effects, so the effect is somewhat lower but at least €600 per company car

• About 700,000 company cars in the Netherlands:
  • Annual aggregate welfare loss: €420 to €600 million
Conclusions

- Households spend more on cars than socially desirable
  ...in the Netherlands and in other European countries (except Scandinavian countries)

- Tax authorities must increase the tax on company cars