Passenger Car Taxation in India: Shifting to an Emissions-Linked Tax Structure

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Why vehicle tax structures need to be examined?

Taxes can serve as a check placed by the government to curb negative externalities (societal costs) from the production or consumption of a given good.

In the case of cars, such externalities include:

- **CO_2 emissions (fuel consumption)**
- **Air pollution**
- **Congestion**

So, the question at hand is:

Is India's taxation structure for cars commensurate with such objectives?

Consumers pay 4 major taxes on the purchase of a car in India, as percentage of vehicle price

Base GST

28% for ICE
5% for EVs

GST discount for EVs - helps to signal the market towards long term EV transition.

The tax is not based on the vehicle specifications

Cess

0% - EVs

ICE vehicles:
1%
3%
15%
17%
20%
22%

Based on specifications
- Length
- Engine cc
- Fuel type
- Ground clearance

Road tax

Between 4% to 18%

State-level tax

Few states give partial to full waiver to EVs

Tax Collected at Source

1%

EV are not exempt

While EVs are already exempt from cess, further analysis on cess structure is needed

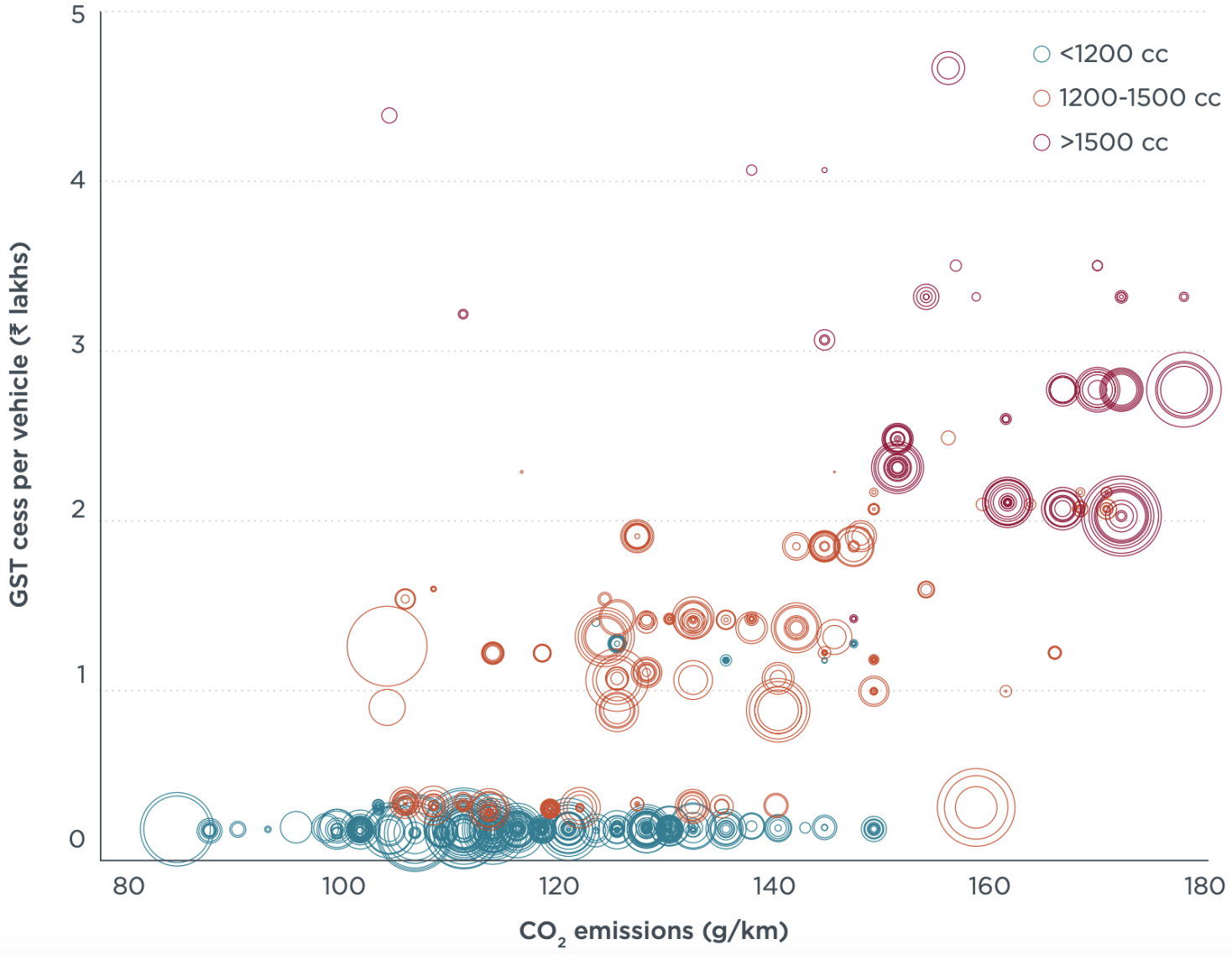
To align with global decarbonization efforts in road transport, **India's car market must transition to 100% EV by 2035-2040.**

During this period of transition, new ICE vehicles will continue to be sold, presenting significant untapped potential for efficiency improvements in India's existing ICE fleet.

Exempting EVs from GST cess supports the long-term shift to electric vehicles, further analysis is needed to determine how fuel-efficiency improvements on ICE vehicles can be optimized during the transition phase.

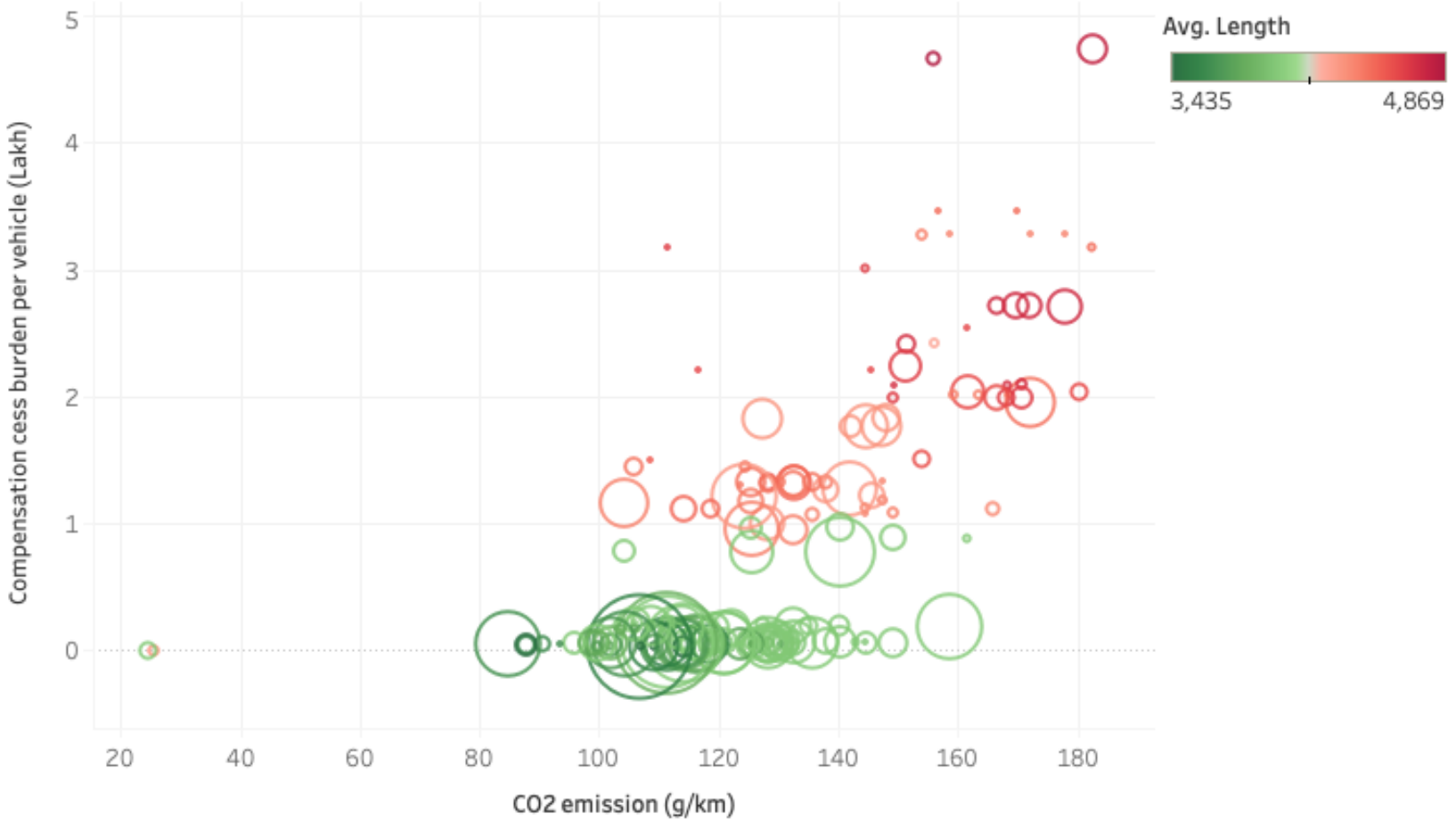
Does the existing structure levy cess commensurate with CO_2 emissions of the vehicles?

Wide disparities in CO_2 emissions vs. tax levy observed



Engine displacement does not serve as an effective proxy for CO_2 emissions.

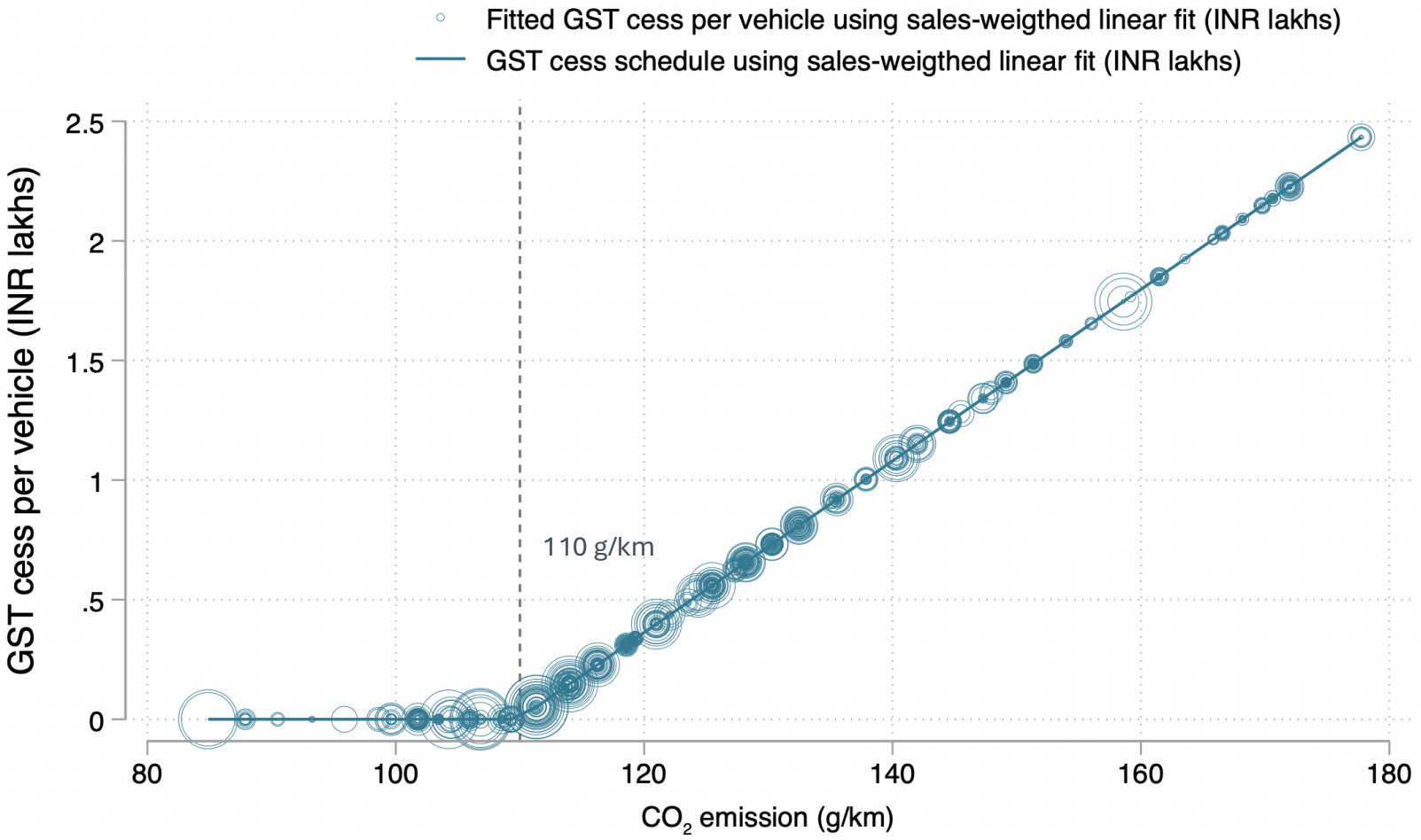
CO_2 emissions vs. tax disparities are found within both bigger cars and smaller cars



Generally, smaller cars (< 4m) are subject to 1% tax slab. This does not support best-in-class fuel efficiency attainment for small cars as a segment.

Same holds true for bigger cars. Some cars are far more fuel-efficient, some are not, but tax does not vary much.

ICCT modelled structure: Continuous emissions-linked tax function



Step 1: Obtain linear best fit line by regressing CO_2 emissions vs baseline cess for PC fleet

Step 2: Set cess for low emission vehicles to zero instead of negative cess (rebate)

Step 3: Adjust the cess best fit line, while keeping the slope unchanged, to ensure baseline revenue neutrality

Hypothetical linear structure levies INR 3,600 (US$49) for every additional gram of CO_2 above 110 g/km.

Complementary policy levers can play a big role in bringing fuel-efficiency improvements to market

- On the supply side: Corporate Average Fuel Economy (CAFÉ) norms that require manufacturers to make more fuel-efficient models.
- On the demand side: Taxation structure that incentivizes consumers to choose more fuel-efficient models.

Roundtable discussion

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