
Submission to the Review of Australia's Future Tax System

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1. SUMMARY

The FCAI is the peak industry organisation representing vehicle manufacturers and importers of passenger vehicles, light commercial vehicles and motorcycles in Australia.

The FCAI notes that in purchasing and operating a new motor vehicle, Australian motorists incur a range of taxes and other government charges which, combined, can impose a significant financial burden.

In particular, these can include the following:

- Customs duty of up to 10 per cent of the Free-On-Board (FOB) price for imported vehicles;
- Goods and Services Tax (GST) at 10 per cent;
- Luxury Car Tax for relevant vehicles, priced over \$57,180 (GST inclusive price);
- Fringe Benefits Tax on many vehicles which are used for business, or purchased by employees under salary packaging arrangements; and
- Stamp duties on the value of the vehicle (around 3-5% of vehicle price).

The FCAI recognises that motorists and vehicle buyers are expected to make a fair and appropriate contribution to the Government's taxation revenue requirements. However, the FCAI urges the Review to consider the impact of existing taxation arrangements on the Australian automotive industry and the vehicle market.

In particular, this submission urges the Review to consider two key aspects of the taxation of motor vehicles that may warrant further detailed analysis, namely: the current Fringe Benefits Tax arrangements and the Luxury Car Tax.

1.1 Fringe Benefits Tax

The current Statutory Formula provides an administratively simple and efficient method of calculating the value of fringe benefits associated with the provision of a motor vehicle to an employee.

The Statutory Formula has been the subject of much public debate however, this debate has not been substantiated with sound empirical evidence.

It is noted that the evidence that the current Statutory Formula creates an incentive to increase distance travelled is equivocal, at best.

Similarly, the extent to which the current FBT treatment of motor vehicles is 'concessional' warrants a more detailed analysis.

The FCAI submits that the Review should undertake a detailed analysis of the impact of the current Statutory Formula on the incentive for vehicle use.

The FCAI urges the Review to evaluate a range of policy options compared with the status quo of retaining the existing Statutory Formula. In determining any recommendations, the FCAI urges the Review to consider carefully the implications for the Australian car industry and to consult affected stakeholders.

1.2 Luxury Car Tax

The Luxury Car Tax (LCT) is an inefficient, punitive and poorly designed tax which gives rise to a significant distortion in the Australian vehicle market. The discriminatory nature of the LCT is reinforced by the fact that the Australian Government singles out the Australian automotive industry and does not tax other 'luxury' items such as yachts or jewellery in a similar manner.

The FCAI contends that the LCT is a thinly disguised non-tariff measure and an effective disincentive for the introduction of leading-edge safety and environmental technologies in the Australian new vehicle market.

The FCAI is particularly concerned about the increase in the incidence of the LCT. The proportion of vehicles subject to LCT has quadrupled over time from around 2.5 per cent of vehicles in 1979 to more than 11 per cent in 2007. The increasing incidence in the LCT reflects the inadequate level of the existing LCT threshold and systematic flaws in the current method of indexation of the LCT threshold.

The recent increase in the rate of LCT to 33 per cent has compounded the already significant adverse impact that the LCT has on the Australian vehicle market.

The FCAI submits that the LCT should be abolished.

2. FRINGE BENEFITS TAX

The 2008-09 Federal Budget estimated that the value of Fringe Benefits Tax is \$4.1 billion which is raised from a number of items, typically motor vehicles and computers. Whilst the value of FBT raised from motor vehicles is not publicly available, the FCAI estimates that there are approximately 500,000 vehicles that incur FBT which could raise as much as \$2.5 billion in FBT annually.

The intention of FBT is to ensure that income tax is not avoided by providing non-taxable items to employees, in lieu of taxable income. FBT is imposed on motor vehicles provided to employees by business, or packaged as part of their remuneration arrangements, when they are used for a combination of both business and personal purposes. In principle, the FBT impost aims to estimate the personal income gained by the employee through the provision of the non-taxable item (i.e. a motor vehicle).

Under current arrangements, businesses can calculate the FBT associated with a motor vehicle by either:

- The Operating Cost method: which requires a record of all travel related to a vehicle which distinguishes between personal and private use, or:
- The Statutory Formula method: this applies a tax rate based upon the distance travelled by a vehicle annually.

In introducing the Statutory Formula, the government sought to use annual mileage as a proxy to estimate the proportion of the vehicle usage which was for business purposes, see Figure 1 below.

Figure 1: Statutory Formula FBT Rates and Thresholds

Total kilometres travelled during the year	Statutory percentage
Less than 15,000	26%
15,000 to 24,999	20%
25,000 to 40,000	11%
Over 40,000	7%

Source: www.ato.gov.au

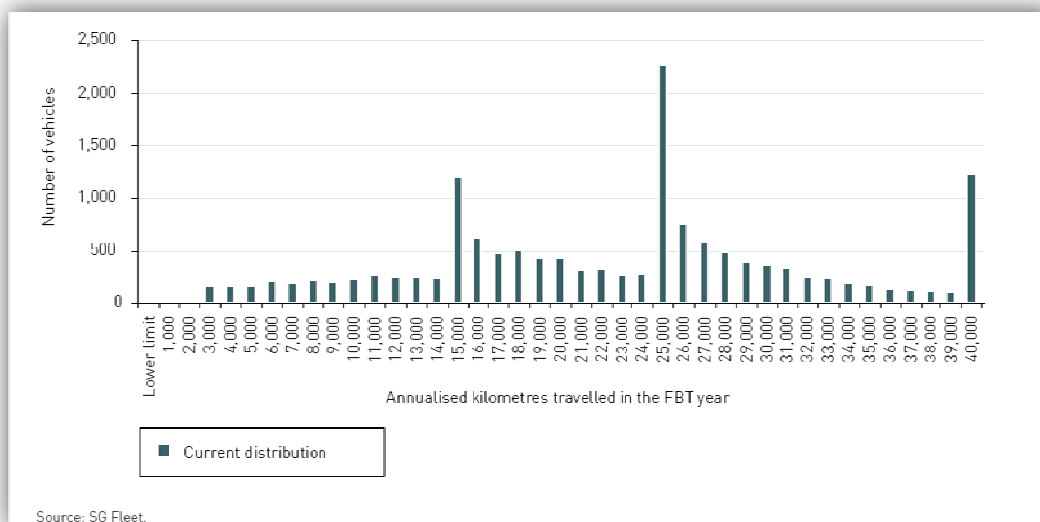
THE STATUTORY FORMULA

The Statutory Formula represents an administratively simple and efficient method of calculating the value of fringe benefits of a motor vehicle, reflecting the mixed business and private usage.

It is noted that the 2008 Review of Australia's Automotive Industry (the Bracks Review) reported that, "there is anecdotal evidence that current FBT arrangements encourage drivers to increase the amount of kilometres driven in order to reduce FBT liability." The Bracks Review also canvassed at least one possible alternative to the basis for the Statutory Formula. While this may provide a basis for more detailed analysis by this Review, a number of other viable options may also be worthy of consideration.

Data presented to the Bracks Review (see Figure 3) below provided prima facie evidence that the current statutory fractions distort driver behaviour. This data is the reported annual kilometres for tax purposes and almost certainly over states the extent to which driver's behaviour is changed by the Statutory Fractions.

Figure 3: Number of Vehicles and Kilometers Traveled in FBT year ended March 2008



When the full cost of this increased travel is taken into consideration, including the cost of fuel, vehicle maintenance and repair, devaluation of the vehicle and time the incentive for further travel is negligible at best.

A financial incentive to increase vehicle usage can occur where, in the normal course of business, a vehicle's annual kilometres travelled remains just below one of the FBT thresholds. In this instance there can be an incentive to increase the vehicles usage to achieve a lower FBT threshold.

A more detailed analysis is required to demonstrate the extent, if any, to which drivers change their travelling behaviour in order to lower their FBT threshold.

As outlined in the Bracks Report, the anecdotal evidence that the current FBT arrangements encourage drivers to increase vehicle use can be addressed through simple changes to the FBT thresholds. The Bracks Report considers one proposal to increase the number of FBT thresholds from four to ten, see Figure 4 below.

Figure 4: Possible Statutory Percentages

Kms/Year	Statutory Fraction
0 – 14000	26%
14001 – 16000	21%
16001 – 18000	19%
18001 – 20000	17%
20001 – 22000	15%
22001 – 24000	13%
24001 – 26000	11%
26001 – 34000	10%
34001 – 40000	9%
40001 +	7%

Source: SG Fleet

Changes to the FBT thresholds, or similar, could remove the incentive for drivers to increase vehicle usage to achieve a lower FBT threshold whilst maintaining the integrity of the FBT regime.

FBT REVENUE IMPACT

Government Budget papers state that the Statutory Formula “may result in the undervaluation of the benefit when calculating fringe benefits tax with the result that less tax is paid on car fringe benefits than would be if the cost of the benefit were paid by the employee out of after tax cash remuneration.”

Based upon this, the 2007 Tax Expenditure Statement, estimates that the cost of the Statutory Formula method of calculating FBT is \$1.49 billion in 2007-08.

Figure 5: Extract from the 2007 Tax Expenditure Statement

D26 Application of statutory formula to value car benefits

Other economic affairs - Other economic affairs, nec (\$m)

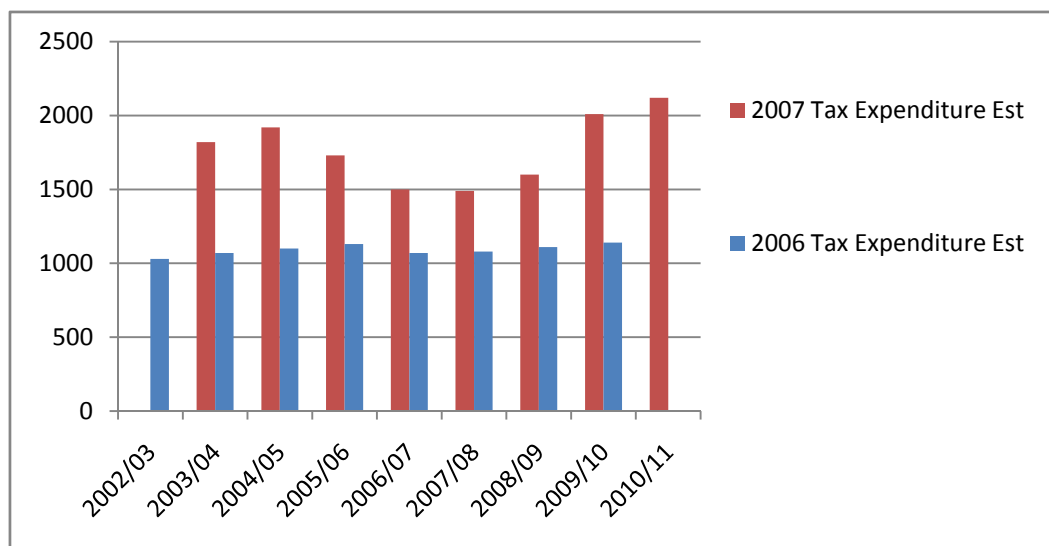
2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
1820	1920	1730	1500	1490	1600	2010	2120
Tax expenditure type:		Discounted valuation				2006 TES code:	D24
Commencement date:		1986					
Expiry date:							
Legislative reference:		Section 9 Fringe Benefits Tax Assessment Act 1986					

Source: Treasury 2007 Tax Expenditure Statement

The decline in the cost of the Statutory Formula over recent years is due to a reduction in income tax rates. Similarly, the forecast increase in the cost of the Statutory Formula is based upon the assumption that average tax rates will increase.

It is noted however, the 2007 Tax Expenditure Statement adopted a new methodology for calculating the cost of the Statutory Formula and as a consequence the estimated cost of the Statutory Formula increased by up to 80 per cent. The Treasury forecast of tax expenditure on the Statutory Formula assumes that, in the absence of the FBT concession, the full value of the vehicles otherwise packaged would be received as income and taxed at the highest marginal rate in the hands of the recipient. This assumption therefore over estimates the revenue implications that arise as a result of the Statutory Formula.

Figure 6 below shows an increase in the estimated cost of the Statutory Formula, as a consequence of the change in accounting methodology.

Figure 6: 2006 and 2007 Forecast Tax Expenditure due to the Statutory Formula

Source: 2006 and 2007 Treasury Tax Expenditure Statements

A more detailed analysis of the revenue implications of the Statutory Formula is warranted to determine the cost, if any, of the method of calculating FBT. This analysis should take into consideration changes in purchasing decisions by businesses that are likely to result if the Statutory Formula was withdrawn as a method of calculating FBT.

CONCLUSION

The current Statutory Formula provides an administratively simple and efficient method of calculating the value of fringe benefits associated with the provision of a motor vehicle to an employee. The Statutory Formula has been the subject of much public debate however, this debate has not been substantiated with sound empirical evidence.

It is noted that the evidence that the current Statutory Formula creates an incentive to increase distance travelled is equivocal, at best. Similarly, the extent to which the current FBT treatment of motor vehicles is 'concessional' warrants a more detailed analysis.

The FCAI submits that the Review should undertake a detailed analysis of the impact of the current Statutory Formula on the incentive for vehicle use.

The FCAI urges the Review to evaluate a range of policy options compared with the status quo of retaining the existing Statutory Formula. In determining any recommendations, the FCAI urges the Review to consider carefully the implications for the Australian car industry and to consult affected stakeholders.

3. LUXURY CAR TAX

The current LCT arrangements were introduced on 1 July 2000 when the GST came into effect, replacing the wholesale sales tax which applied to luxury vehicles.

The LCT defines a car as a motor vehicle that is designed to carry a load of less than two tonnes and fewer than nine passengers and includes:

- Passenger cars;
- Station wagons; and
- Four-wheel drive passenger vehicles.

A luxury car is defined as a car with a GST inclusive price above the LCT threshold.

The LCT threshold for the 2008-09 year is \$57,180 including GST, therefore the LCT applies to vehicles with a base price over \$51,982.

LCT IS A MARKET DISTORTION

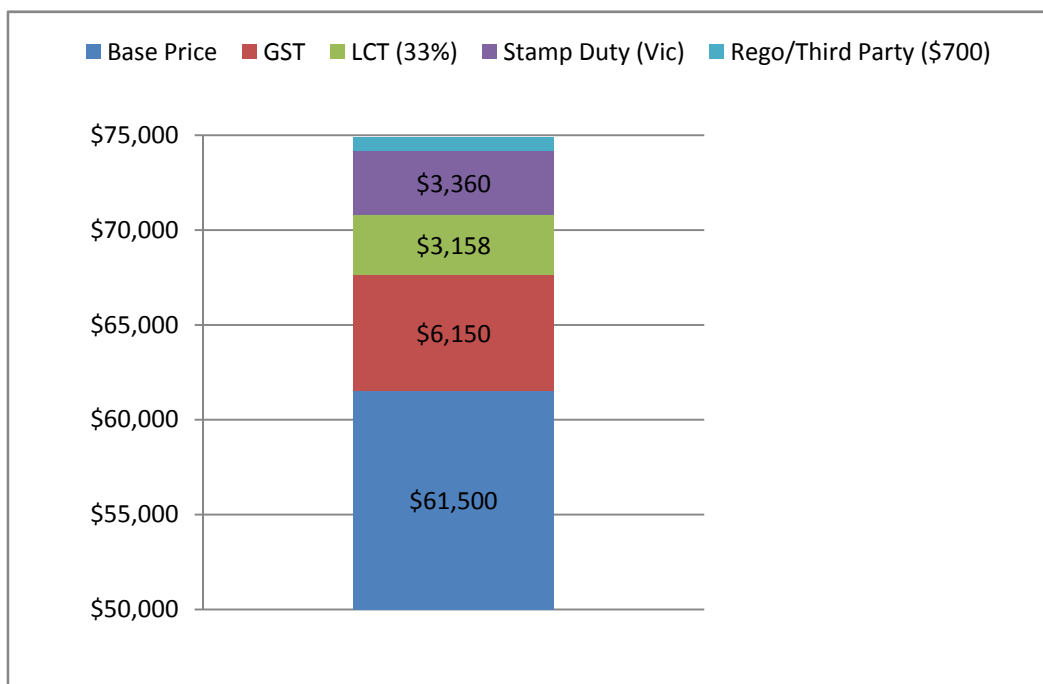
The Luxury Car Tax (LCT) is an inefficient, punitive and poorly designed tax, which gives rise to a significant distortion in the Australian vehicle market. The discriminatory nature of the LCT is reinforced by the fact that the Australian Government singles out motorists and does not tax other 'luxury' items such as yachts or jewellery in a similar manner.

No other product, including private aircraft, jewellery or yachts are defined by the taxation system as luxury items. Similarly, any international example of a 'luxury' tax appear to have been replaced by more efficient methods of taxation.

A more equitable approach to increasing the tax burden of high income earners, rather than the LCT, would be to use the income tax system. Furthermore, the GST is applied to the purchase of a new motor vehicle at a rate of 10% and therefore the higher a vehicle purchase price the greater the tax applied to the vehicle.

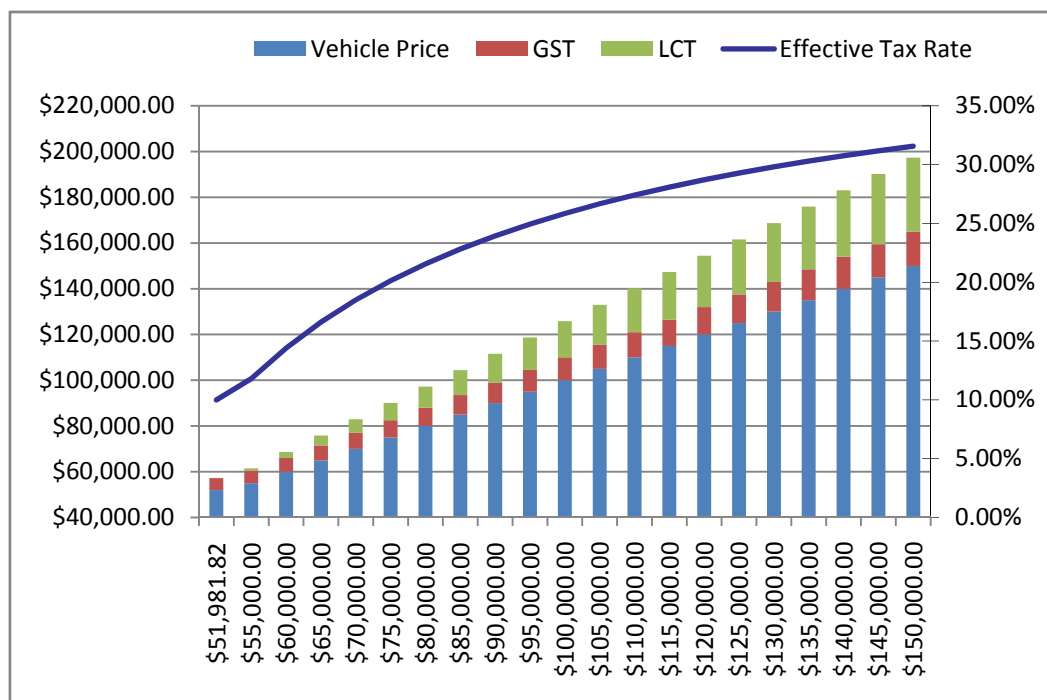
The automotive industry recognises that it has a responsibility to contribute appropriately to government revenue however, motor vehicles are already heavily taxed through a range of state and federal taxes and charges.

The Chart below shows the impact of the multiple taxation arrangements on a motor vehicle with a base price of \$61,500. In addition to the taxes shown below, motor vehicles can also incur FBT, fuel excise and stamp duty on insurance charges.

Figure 7: Multiple Taxation of Motor Vehicles

Unlike the GST which applies at a constant rate of 10% across all vehicles, the rate of taxation of the LCT increases along with the vehicle price. Figure 8 below, shows the cumulative impact of the GST and the LCT which results in the effective rate of taxation on a motor vehicle rising from 10% for a vehicle under the LCT threshold to over 30% for a vehicle with a base price of \$150,000.

Figure 8: Effective Rate of Taxation on Motor Vehicles



The distortionary nature of the LCT has been further exacerbated with amendments to the LCT in 2008 which provided two exemptions from the LCT:

1. Vehicles with fuel consumption of less than 7 litres/100km have a separate LCT threshold of \$75,000 above which the LCT applies;
2. Certain primary producers and tourism operators do not incur the LCT.

Diesel powered vehicles have higher CO₂ emissions than Petrol and LPG at the same fuel consumption. Petrol engines with fuel consumption of 7 litres per 100 Kms produce around 166 grams of CO₂ per 100km, compared to a Diesel engine which is around 10% higher with 184 grams of CO₂ per 100km.

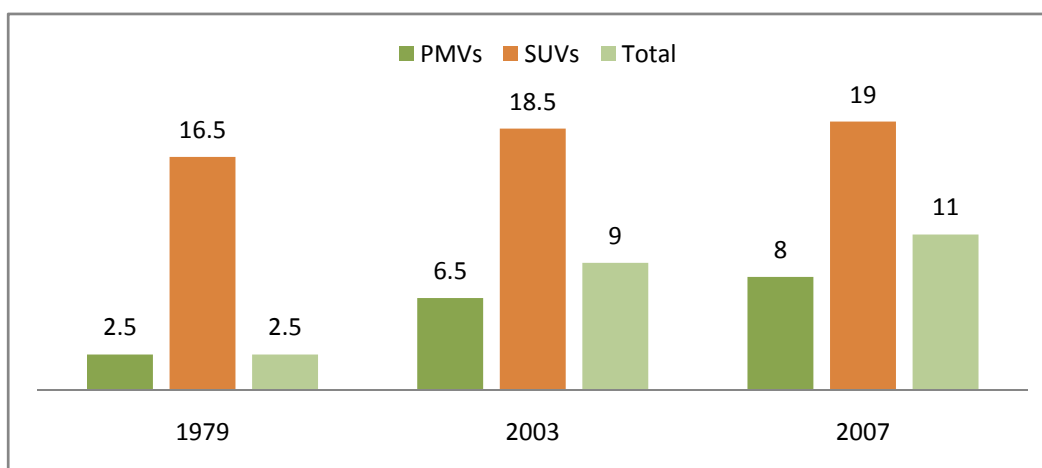
A number of vehicle importers are now planning to replace vehicle models currently sold in Australia with an equivalent diesel powered vehicle, with fuel consumption of less than 7 litres/100km, which has higher carbon emissions than the model currently being sold in Australia.

Finally, the exemption for primary producers and tourism businesses only affects a very small number of businesses and individuals in rural areas that require larger four-wheel drive vehicles and only further exacerbates the distortions in the market place created by the LCT.

INCREASING INCIDENCE OF THE LUXURY CAR TAX

The FCAI is particularly concerned by the growing incidence of the LCT both on imported and locally manufactured vehicles. Work undertaken by the FCAI shows a quadrupling of vehicles exceeding the LCT threshold from around 2.5 per cent in 1979 to more than 11 per cent in 2007 (see Figure 9).

Figure 9: Percentage of Vehicles that Exceed the LCT Threshold



As a result the LCT is now applied to many vehicles which are popular family vehicles and/or vehicles which are predominantly relied upon by people living in rural and regional areas of Australia. This observation is reinforced by analysis of the top-selling models (see Figure 10).

Figure 10: Vehicle Sales Exceeding LCT Threshold – 2007

Rank	Model Group	Sales
1.	Toyota Landcruiser Wagon	6,046
2.	BMW 3 Series	5,676
3.	Toyota Prado	4,807
4.	Holden Commodore	4,556
5.	Mercedes-Benz C-Class	4,169
6.	Mitsubishi Pajero	4,064
7.	BMW X5	3,399
8.	Lexus RX	3,121
9.	Lexus IS250	3,073
10.	BMW 3 Series Coupe/Conv	2,921

When the threshold was first introduced in 1979, only two Australian-made models were priced above this threshold - the Holden Caprice and the Ford LTD - despite the significantly higher market share that local manufacturers held at that time. In 2007, all Australian made vehicle models had variants that exceeded the LCT threshold.

THE LUXURY CAR TAX THRESHOLD AND INDEXATION

The LCT threshold is indexed on 1 July each year, based upon the increase in the motor vehicle purchase sub group for the Consumer Price Index (CPI-MV) for the March quarter of each year.

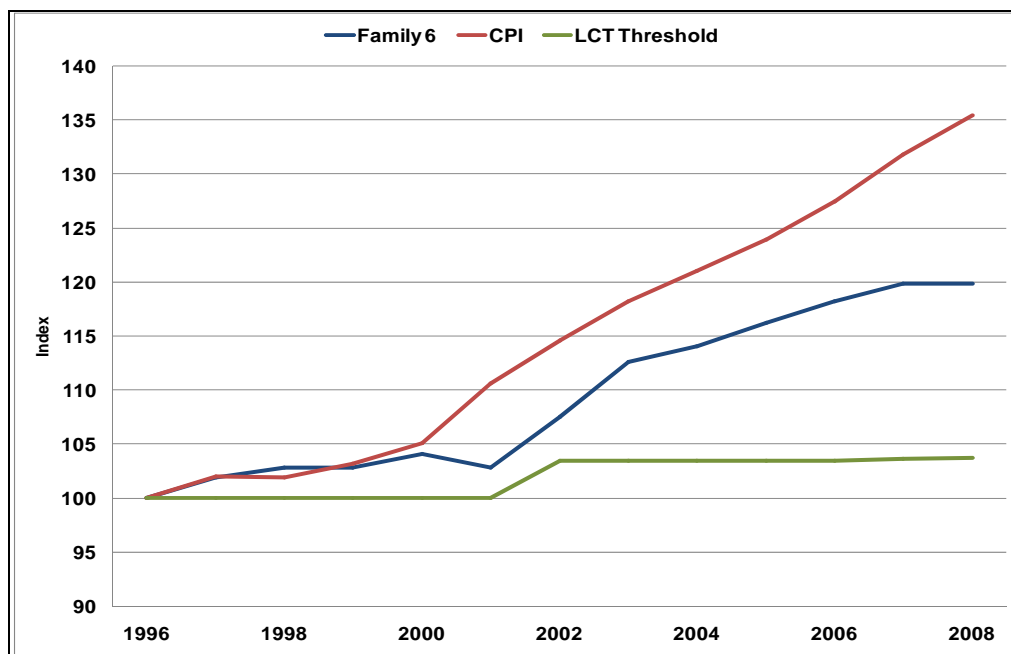
The CPI-MV measures change in the price of motor vehicles over time however, adjustments are made to the index to remove the impact of 'quality' improvements in vehicles that affect motoring performance, economy, comfort level, safety or durability.

Therefore, the CPI-MV seeks to provide a measure of the changing price of motor vehicles without any allowance for the impact of the introduction of features such as electronic fuel injection, ABS brakes, CD players, air-conditioning, air bags or electronic stability control.

The implication is that changes in the CPI-MV bear little or no resemblance to actual vehicle price changes in the market and, as a result, the current approach to indexation of the LCT threshold is deeply flawed.

Since 1996, the LCT threshold has increased from \$55,134 to only \$57,180, or by just 3.6 per cent. In contrast, over the same period the all groups CPI has increased by 35 per cent and the average price of a 'Family 6' sedan has increased by almost 20 per cent (see Figure 11).

Figure 11: LCT Threshold has not Reflected Other Measures of Price Change

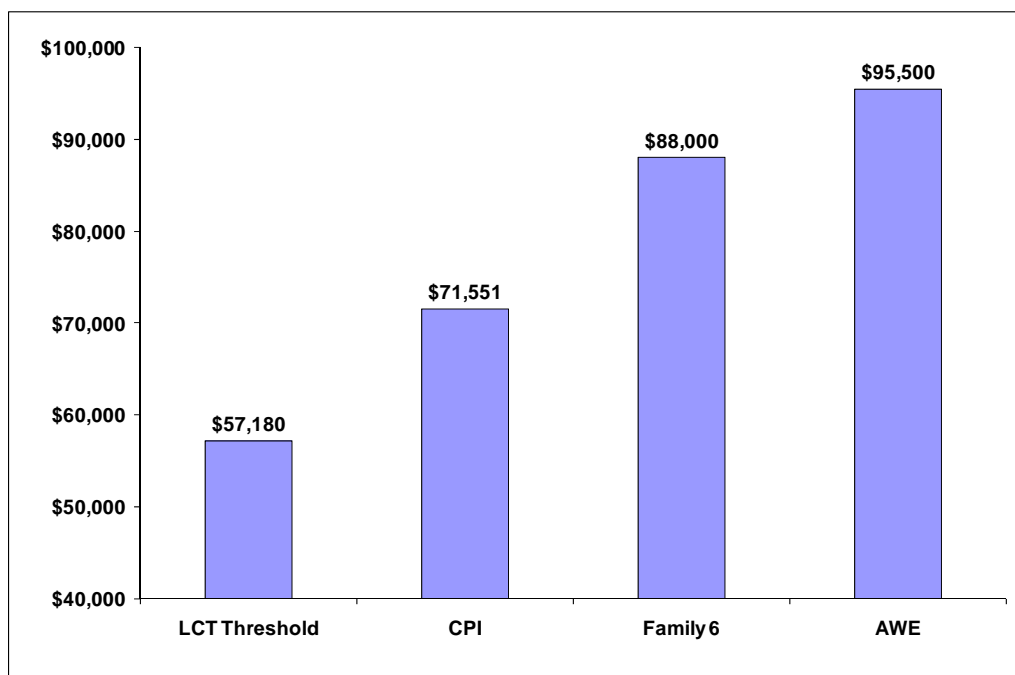


Source: Australian Automotive Intelligence

Figure 12 illustrates the impact of several alternative approaches to indexation. This chart shows what the LCT threshold would be in 2008 had it been indexed using a variety of different indicators, including the CPI, Average Weekly Earnings and the average price of a 'Family 6' cylinder vehicle¹ over the entire period since the original introduction of the LCT threshold in 1979.

¹ The 'Family 6' index is based on changes in the recommended retail price of the base model 6 cylinder sedans with automatic transmission from the Holden Commodore and Ford Falcon ranges.

Figure 12: Alternative Approaches to Indexation of the LCT Threshold



- Source: Australian Automotive Intelligence

If the LCT is to be genuinely a tax on 'luxury' consumption then the LCT threshold should be indexed to ensure that the incidence of the tax does not increase through stealth over time. The central objective of indexation of the LCT threshold should be to minimise 'bracket creep'. This should aim to ensure that 'luxury' cars remain a limited share of new vehicle sales (e.g. 2.5 per cent of new car sales).

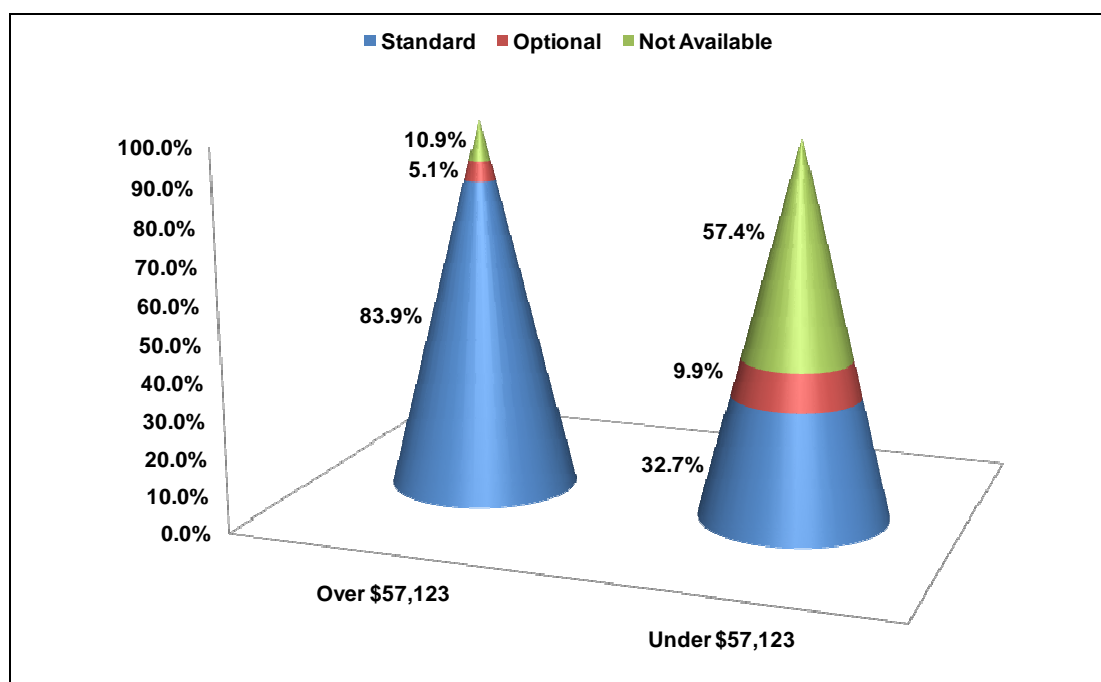
IMPACT ON SAFETY AND THE ENVIRONMENT

The LCT is a tax on the fitting of safety features and the introduction of new lower emission technologies.

Many new safety features and improved fuel efficiency technologies enter the market via more expensive vehicle models. Increasing the taxation on these vehicles raises the cost of these features and risks delaying their introduction to the Australian fleet.

Figure 13 shows, of the percentage of vehicles which exceed the LCT threshold, 84 per cent have life-saving, Electronic Stability Control (ESC) fitted as standard. This is compared to just 33 per cent for vehicles below the LCT threshold.

Figure 13: Fitment of Stability Control: Cars & SUVs – 2007



Source: JATO Dynamics

Furthermore, vehicles with emerging low emission technologies including hybrids and low-emission diesel engines are frequently more expensive than their alternatives. As a consequence these vehicles may also incur a 33 per cent tax, potentially delaying their introduction into the Australian vehicle fleet.

CONCLUSION

The Luxury Car Tax (LCT) is an inefficient, punitive and poorly designed tax, which gives rise to a significant distortion in the Australian vehicle market. The discriminatory nature of the LCT is reinforced by the fact that the Australian Government singles out motorists and does not tax other 'luxury' items such as yachts or jewellery in a similar manner.

The FCAI contends that the LCT is a thinly disguised non-tariff measure and an effective disincentive for the introduction of leading-edge safety and environmental technologies in the Australian new vehicle market.

The FCAI is particularly concerned about the increase in the incidence of the LCT. The proportion of vehicles subject to LCT has quadrupled over time from around 2.5 per cent of vehicles in 1979 to more than 11 per cent in 2007. The increasing incidence in the LCT reflects the inadequate level of the existing LCT threshold and systematic flaws in the current method of indexation of the LCT threshold.

The recent increase in the rate of LCT to 33 per cent has compounded the already significant adverse impact that the LCT has on the Australian vehicle market.

The FCAI submits that the LCT should be abolished.