Submission to the Senate Economics Committee

Inquiry into the Tax Laws Amendment (Luxury Car Tax) Bill 2008

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Key Points

The Federal Chamber of Automotive Industries (FCAI) strongly opposes the proposed increase in the rate of the luxury car tax (LCT) from 25 per cent to 33 per cent.

An increase in the rate of LCT would compound the already significant distortionary impact that the existing tax has on the Australian vehicle market with adverse consequences for motorists, industry and the community.

Analysis undertaken by the FCAI reveals that the reach of the LCT has expanded significantly over time and that the tax now captures many more vehicles and model types than at the time of its introduction. In 2007, it was estimated that more 11 per cent of passenger car and SUV sales exceeded the LCT threshold, compared with only around 2.5 per cent of sales of these vehicles, when the threshold was first implemented in 1979.

The increasing number of vehicles and model types captured by the LCT reflect serious methodological flaws in current arrangement for the indexation of the LCT threshold.

The FCAI is concerned that the LCT now applies to an expanding range of family vehicles and to vehicles which are particularly prevalent in rural and regional areas. Indeed, for many families vehicles subject to LCT are strongly preferred on safety grounds and should not be considered as 'luxury' items.

Research also shows that innovative safety and environmental technologies first permeate the market through the premium or 'luxury' segments of the market. An increase in the LCT rate is likely to serve as a disincentive for motorists to buy vehicles with advanced safety and environmental features, undermining the uptake of emerging technologies in the Australian vehicle market.

There are few international precedents for the taxation of 'luxury' items which come close to the Australian LCT. By international standards the proposed LCT rate of 33 per cent is punitive and the threshold for application of the tax is very low. Equally, the discriminatory nature of the LCT is reinforced by the fact that the Australian Government singles out the Australian car industry and does not tax other 'luxury' items in a similar manner.

The FCAI also acknowledges concerns that the LCT may be construed as an effective non-tariff barrier, due to its disproportionate impact on imported vehicles. As such, the tax undermines the policy of successive Australian Governments to undertake progressive reform of the economy through the reduction and elimination of barriers to freer trade and investment.

In addition, the FCAI expresses concern about the complete lack of transitional arrangements for the implementation of the proposed increase in the LCT rate. In particular, if the Bills are passed in their current form, they would apply retrospectively to sales completed from 1 July 2008. Moreover, it is clear that there is significant ongoing uncertainty for industry and vehicle buyers about the impact of transitional arrangements for the application of any increase in the LCT rate, based on current advice provided by the Australian Taxation Office. This uncertainty can only be resolved by a clear statement by the Australian Government that it defer any change in LCT arrangements until the passage of legislation by the Australian Parliament.

Recommendations:

In determining its recommendations arising from this inquiry, the FCAI urges the Senate Economics Committee to consider the following options:

1. Oppose the proposed increase in the LCT rate and/or consider amendments that would moderate the adverse implications of the proposed increase on key affected groups, including those living in rural and regional areas; small businesses and tourism operators; local vehicle manufacturers; and vehicle importers and distributors.

2. Consider the scope to increase the LCT threshold to reduce its distortionary impact on the Australian vehicle market and to return the incidence of the tax to its original policy intent.

3. Consider alternative approaches for the indexation of the LCT threshold to overcome the serious deficiencies in the existing method and to ensure that future adjustments more accurately reflect future changes in the Australian vehicle market.

4. Consider amendments which will ensure that any adjustment in the rate of LCT will not be retrospectively applied to purchases of vehicles undertaken prior to the passage of legislation by the Australian Parliament.

5. Observe that, consistent with its terms of reference, the forthcoming Review of the Australia's Future Tax System would be expected to consider the impact, design and effectiveness of the LCT, along with other elements of the Australian tax system.

Introduction

The Federal Chamber of Automotive Industries (FCAI) provides the following submission to the Senate Economics Committee Inquiry into the *Tax Laws Amendment (Luxury Car Tax) Bill 2008* and related *Bills*.

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

This submission outlines the industry's concerns with the proposed increase in the luxury car tax (LCT) rate from 25 per cent to 33 per cent.

It is the FCAI's submission that the proposed increase in the LCT rate exacerbates the negative and distortionary impact that the tax already has on the Australian vehicle market. In particular, the proposed increase in the LCT rate will adversely affect key groups in the Australian community, including many living in rural and regional areas.

The FCAI urges the Economics Committee to oppose the proposed increase in the LCT rate, or to recommend amendments which will significantly moderate the most negative impacts of the Bills in their current form.

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.

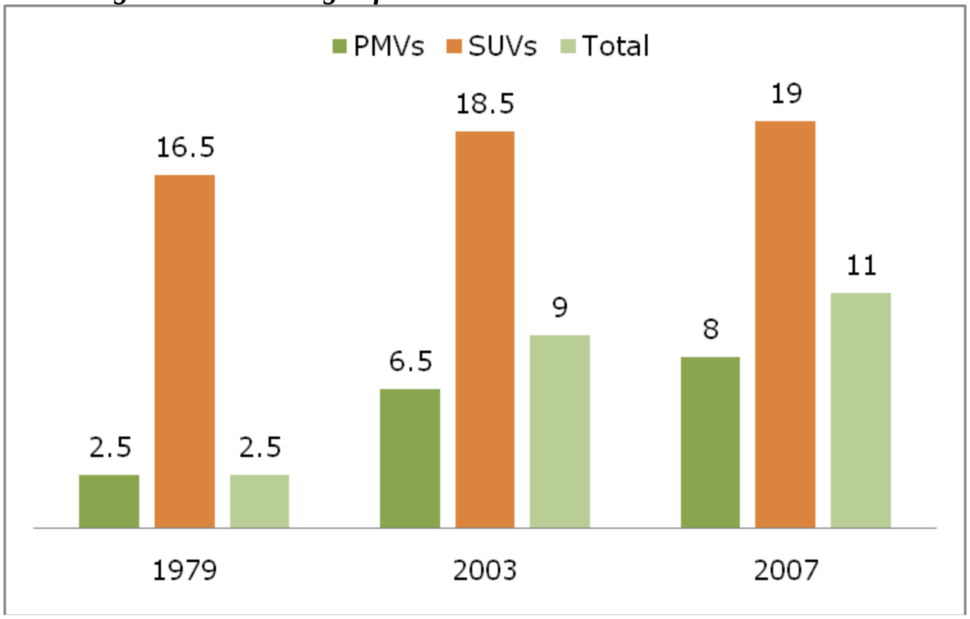
Work undertaken for the FCAI shows a quadrupling of vehicles exceeding the LCT threshold from around 2.5 per cent in 1979 to more than 11 per cent in 2007 (see Figure 1).

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 some of top-selling models (see Figure 2).

When the LCT threshold was first introduced (in 1979), only two Australian-made models 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 exceed the LCT threshold.

It would be surprising to many people to consider that Australia's top selling 'luxury' vehicle is not a Porsche, Ferrari, Maserati, Lamborghini, Rolls Royce, Bentley, or even an Aston Martin, indeed these brands are not represented in the top 20 model sales of 'luxury' cars using the LCT definition (or even the top 40). Australia's top selling 'luxury' vehicle is a Toyota – the LandCruiser Wagon.

Figure 1: Percentage of Vehicles that Exceed the LCT Threshold



Source: Australian Automotive Intelligence

Figure 2: 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
11.	Mercedes-Benz M-Class	2,453
12.	Holden Caprice/Statesman	4,005
13.	Ford Territory	2,080
14.	Mercedes-Benz E-Class	2,007
15.	Volvo XC90	1,905
16.	Ford Falcon	1,687
17.	Ford Fairlane	1,581
18.	BMW 5 Series	1,552
19.	Toyota Kluger	1,549
20.	Land Rover Discovery	1,482

Source: FCAI VFACTS

Impact on Rural and Regional Communities

For those living in rural and regional areas access to safe, reliable and convenient family transport is essential.

For many people the requirements of driving on unsealed roads, particularly during flooding and the 'wet season'; the need for enhanced vehicle durability and protection from wild-life; as well as long-range fuel capacity are the key determinants of vehicle choice. As a consequence, for many people living in rural and regional areas four wheel drive vehicles are considered essential, not a 'luxury'.

It is of concern therefore that the incidence of the LCT is higher on four wheel drives than any other type of vehicle.

It is estimated that more than 70 per cent of all sales of Toyota LandCruiser Wagon – the highest selling four wheel drive vehicle in rural and regional areas - currently incur LCT.

This situation is likely to worsen in coming years, given the failure of the LCT threshold to keep pace with the changes in the motor vehicle market. Indeed, if current trends continue it is possible that all sales of Toyota LandCruiser Wagon, Mitsubishi Pajero 5 Door and Nissan Patrol Wagon models will exceed the LCT threshold within the next 5 years.

Impact on Small Business and Tourism Operators

The LCT is applied to businesses vehicles. Many businesses require unique, premium or four wheel drive vehicles in order to undertake their business.

Small business, including trades people and eco-tourism operators who require four wheel drive vehicles to undertake their business activities are more likely therefore to incur the LCT. These businesses require a specific type of vehicle in order to undertake their business operations and it is therefore inappropriate to deem them to be 'luxury' vehicles.

The successful operation of many of these businesses is of major importance to the many small, regional and coastal communities where they are located. Extra taxation burdens could have significant, adverse impacts on their business.

Impact on Safety and the Environment

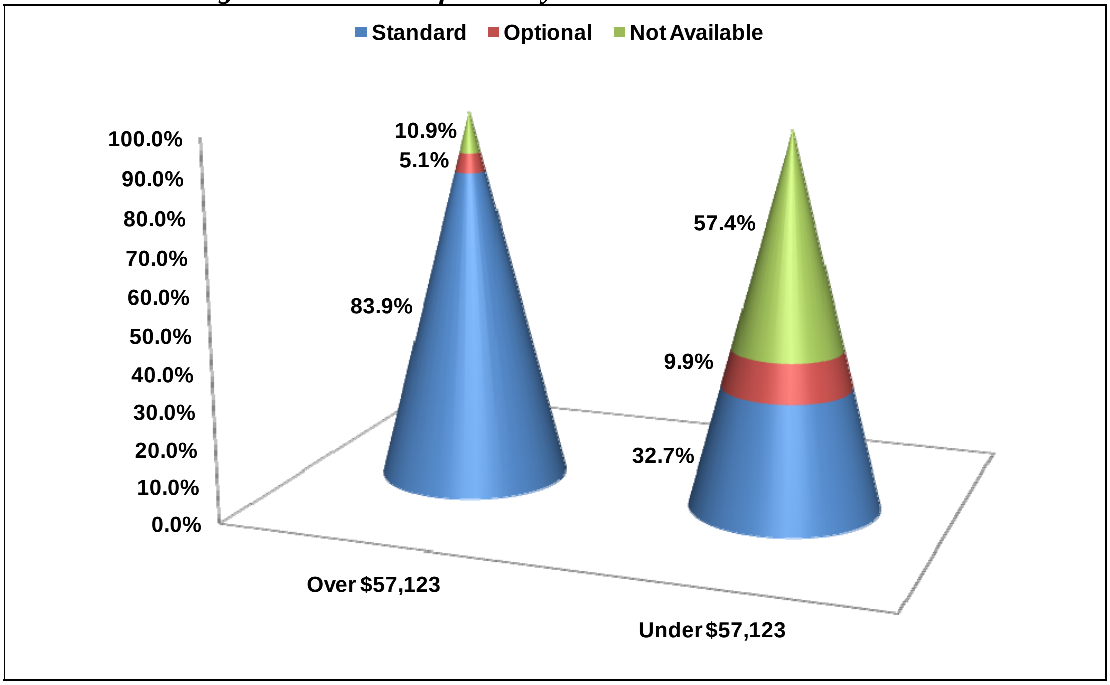
The LCT is a tax on the fitment of safety features and lower emission technologies.

The impact of the LCT is to create a disincentive for the fitment of emerging safety and environmental technologies to Australian vehicles. For example, if a customer seeks the fitment of airbags to a vehicle priced over the LCT threshold then the customer will incur a 33 per cent tax on the fitment of the airbags.

Many new safety features and improved fuel efficiency technologies do 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 3 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 3: 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.

Key Points/Recommendations:

The proposed increase in the LCT rate will exacerbate the negative and distortionary impact of the tax and adversely affect key groups in the Australian community, including many living in rural and regional areas. Accordingly The FCAI urges the Senate Economics Committee to:

- Oppose the proposed increase in the LCT rate and/or consider amendments that would moderate the adverse implications of the proposed increase on key affected groups, including those living in rural and regional areas; small businesses and tourism operators; local vehicle manufacturers; and vehicle importers and distributors.

- Consider the scope to increase the LCT threshold to reduce its distortionary impact on the Australian vehicle market and to return the incidence of the tax to its original policy intent.

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.

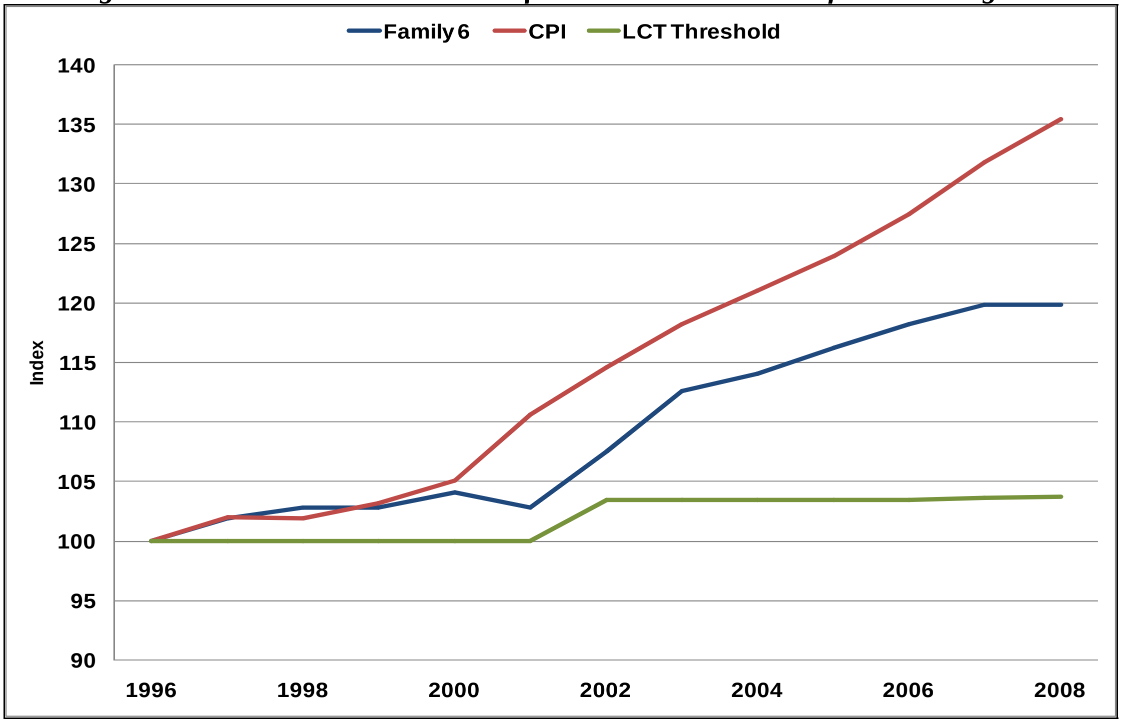
The CPI-MV measures change in the price of motor vehicles over time however, adjustments are made to the index to remove the impact of 'quality' improvements in vehicles that affect motoring performance, economy, comfort level, safety or durability.

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 4).

Figure 4: LCT Threshold has not Reflected Other Measures of Price Change



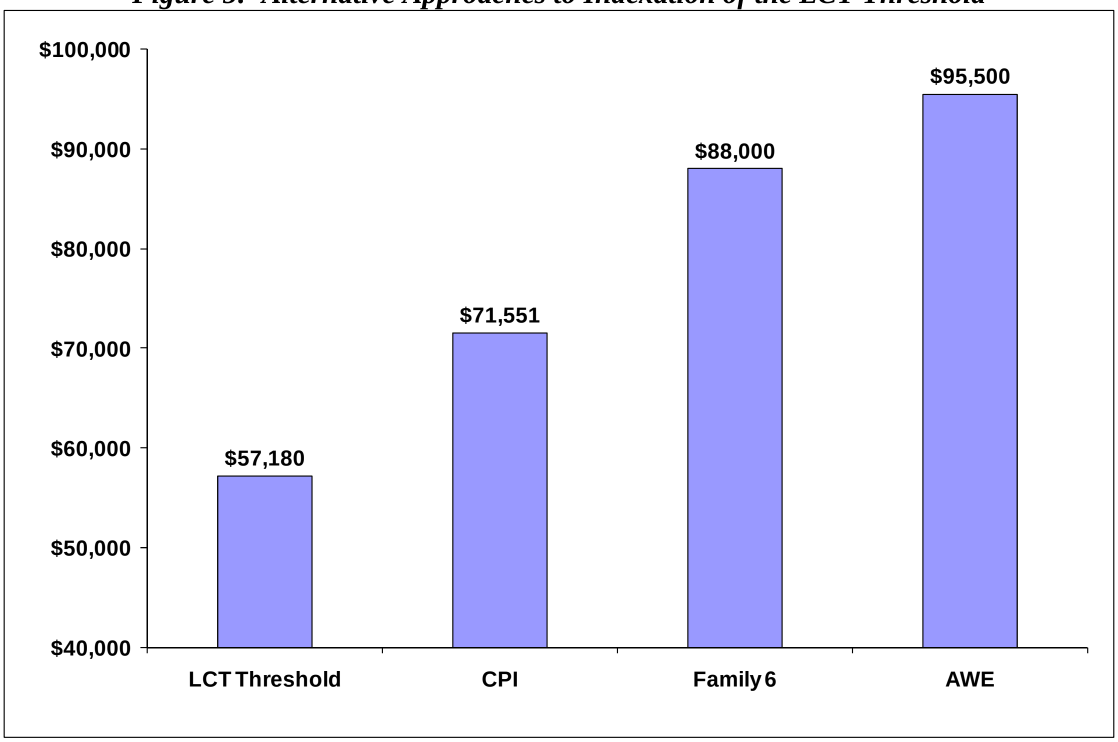
Source: Australian Automotive Intelligence

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 vehicles sales (e.g. 2.5 per cent of new car sales).

This might be better reflected if indexation of the LCT threshold is linked to a broader measure of price inflation or consumer purchasing power, such as the all groups CPI, or average weekly earnings.

Figure 5 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.

Figure 5: Alternative Approaches to Indexation of the LCT Threshold



Source: Australian Automotive Intelligence

[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.

Key Points/Recommendations

The FCAI submits that current arrangements for the indexation of the LCT threshold are deeply flawed and have contributed to the expanding incidence of the tax over time. The FCAI urges the Senate Economics Committee to:

- Consider alternative approaches for the indexation of the LCT threshold to overcome the serious deficiencies in the existing method and to ensure that future adjustments more accurately reflect future changes in the Australian vehicle market.

Implementation Issues

Proposed arrangements for the implementation of the 2008-09 Budget measure to increase the rate of the LCT from 25 per cent to 33 per cent, with effect from 1 July 2008, have created widespread concern and confusion in the industry.

In particular, this concern and confusion stems from several issues:

1. The tax increase is proposed to be applied retrospectively to purchases of new motor vehicles which were in place prior to the Budget announcement of 14 May, but where 'taxable supply' does not to take place until after 1 July.

2. The uncertain application of the tax increase to purchases of new motor vehicles which have been entered into after 14 May but where 'taxable supply' will not take place until after 1 July but prior to passage of implementing legislation.

3. Advice provided by the Australian tax Office, in relation to its interpretation of what constitutes the 'taxable supply' of a luxury car, appears to differ from the principles for determining 'taxable supply' of other goods and services.

On 23 June the Tax Commissioner released advice seeking to provide clarification of the intended application of the proposed LCT rate increase. In so doing, the Tax Commissioner stated that:

> *"It is now clear the legislation will not be passed [by 1 July]. However, if passed at a later date, the proposed law in its present form will apply retrospectively from 1 July 2008."*
>
> *"If the law is enacted, motor vehicle suppliers will need to report and pay the additional 8 per cent tax on luxury cars delivered from 1 July 2008. They are entitled to pass on the additional tax to their customers.*
>
> *"So if a car is ordered after 1 July but before the law is passed, motor vehicle suppliers can charge a higher price to cover the extra tax that will become payable if the law is passed. Alternatively, they can enter into contracts with customers that require customers to pay the amount of the extra tax after the law is passed.*
>
> *"Where a luxury car is ordered but not delivered before 1 July, the supplier is entitled to include the extra luxury tax in the price of the vehicle. This is because the rate of luxury tax is determined by the date of delivery, not the date the order is placed.*
>
> *'The current law continues to apply until the proposed law is enacted, which means the luxury tax will continue to be 25 per cent until then."*

In effect, the Tax Commissioner's advice requires car dealers and their customers to make an assessment of the likelihood that the Australian Parliament will pass implementing legislation, unamended.

In the absence of passage of legislation, car dealers have been unsure of the legal basis for charging the increased LCT and face the unpalatable decision about whether to seek to pass on this prospective increase to their customers although they may have no legal basis for doing so, or whether to absorb the commercial and financial risk that their customers will honour a retrospective increase in their tax liability at some point in the future.

If the legislation is enacted, dealers will be required to report and remit the additional LCT in full in the first tax period that commences after the law is enacted. In instances where the consumer refuses to meet the additional LCT liability, the dealer remains liable to the Government for the tax, including any uncollectible component.

Moreover, the purchase of a car can be more complex than the purchase of other goods or services and frequently involve complex finance and leasing arrangements, with delivery often being delayed over a period of months, or more.

Changes in the price of a vehicle require adjustments to contracts and finance leases, with a subsequent impact on stamp duty and other government charges that are applied on top of the LCT.

The cost of compliance during the transitional period places a significant burden on dealers and distributors. It has been necessary to adapt IT and accounting systems, establish additional reporting and contractual arrangements, collect and hold the additional LCT in trust, make provisions for refunds pending variations to the Bill and to remit the LCT liability for customers that refuse to pay and adapt advertising campaigns to ensure compliance with the Trade Practices Act.

Furthermore, it can take many months from the placement of an order for a motor vehicle, until the date of delivery. Many customers now face the proposed retrospective application of this tax increase despite having entered into agreement for the purchase of a vehicle before the Budget announcement on 14 May 2008.

Key Points/Recommendations:

The FCAI expresses concern about the extent of ongoing confusion and uncertainty among customers and industry in relation to the implementation of the proposed increase in the LCT rate. The FCAI urges the Senate Economics Committee to:

- Consider amendments which will ensure that any adjustment in the rate of LCT is not retrospectively applied to purchases of vehicles undertaken prior to the passage of legislation by the Australian Parliament.

Future Reform

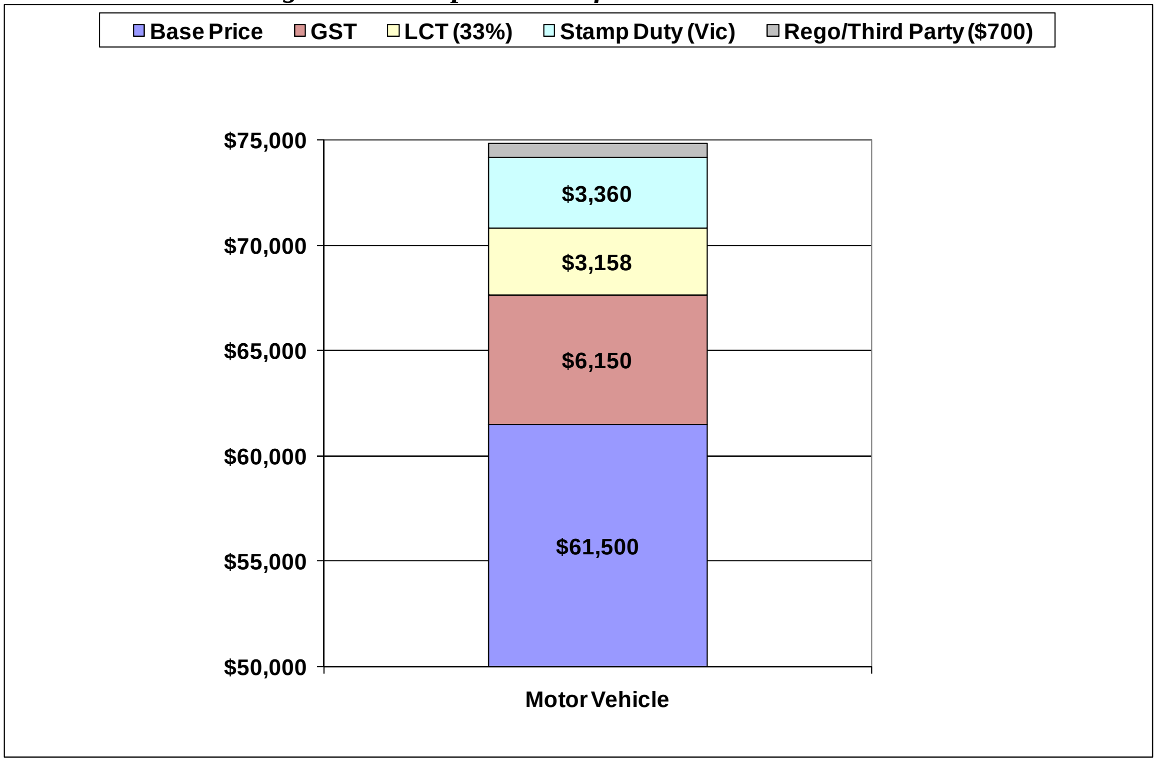
The combination of multiple taxes and State Government charges means that motorists must shoulder a significant financial burden when purchasing a new motor vehicle.

In particular this can include the following:

- Customs duty of up to 10 per cent of the fob price for imported vehicles;
- Goods and services tax at 10 per cent;
- Luxury car tax for relevant vehicles, priced over $57,180 (GST inclusive price);
- Fringe benefits tax on many business vehicles;
- Stamp duties on the value of the vehicle (around 3-5%);
- Registration fees and compulsory third party insurance;
- Taxes on the operating costs of the vehicle including fuel excise, and stamp duty on insurance, and;
- Limits on the ability to depreciate the capital value of business vehicles, above the LCT threshold.

Figure 6, below, illustrates the impact of the multiple taxation arrangements on a motor vehicle. In this case a vehicle with a base price of $61,500 (equivalent to the cost of a Toyota Tarago Ultima or a Toyota LandCruiser GXL), incurs an overall tax impost of $12,500, including $6,150 GST and more than $3,000 in LCT, lifting the final price to the consumer to around $74,000.

Figure 6: Multiple Levels of Motor Vehicle Taxation



Source: FCAI

There are few international precedents for the taxation of 'luxury' items which come close to the Australian LCT. By international standards the proposed LCT rate of 33 per cent is punitive and the threshold for application of the tax is very low. Equally, the discriminatory nature of the LCT is reinforced by the fact that the Australian Government singles out the Australian car industry and does not tax other 'luxury' items in a similar manner.

The FCAI also acknowledges concerns that the LCT may be construed as an effective non-tariff barrier, due to its disproportionate impact on imported vehicles. As such, the tax undermines the policy of successive Australian Governments to undertake progressive reform of the economy through the reduction and elimination of barriers to freer trade and investment.

In opposing the proposed increase in the LCT rate the FCAI does not seek to undermine the Australian Government's broader Budget objectives, nor does it demur from the responsibility of the Australian automotive industry to make a fair and appropriate contribution to the Government's overall revenue task. Rather the FCAI believes that it is appropriate to consider a broader range of options, capable of securing the Government's revenue objectives.

Accordingly the FCAI urges the Australian Government to take advantage of key policy reviews that it has initiated to consider alternatives to the proposed LCT rate increase and to consider options for the fundamental reform or abolition of the LCT.

Key Points/Recommendations:

The FCAI notes that consumers already face a significant tax impost when buying a new car. The impact of taxation arrangements on the Australian automotive industry are legitimately the subject of several reviews initiated by the Australian Government. The FCAI contends that it is premature to seek to implement an increase in the LCT rate in advance of the outcome of these reviews. In particular, The FCAI invites to Senate Economics Committee to:

- Observe that, consistent with its terms of reference, the forthcoming Review of the Australia's Future Tax System would be expected to consider the impact, design and effectiveness of the LCT, along with other elements of the Australian tax system.