

# Appendix 4

## Car fringe benefits tax:

### Questions to Treasury and Treasury's answers

#### The committee's questions:

#### QUESTIONS TO TREASURY - CAR FRINGE BENEFITS TAX

Concerning tax expenditure D24 relating to the concessional taxation of car fringe benefits by the statutory formula method (2008 Tax Expenditures Statement, p163):

1. How are the tax expenditure amounts estimated and what are the input data used? Please give details of the data used relating to the years shown in the 2008 Tax Expenditures Statement.
2. What is the reliability of the estimate for past years?
3. What is the reliability of the estimate for future years?
4. How are the amounts of actual private and work-related use by the affected cars estimated?
5. Is taxation of cars by the operating costs method concessional (as could be the case for example if the statutory depreciation and interest rates were out of step with true depreciation and interest rates)? If so, what is Treasury's estimate of the tax expenditure, and is it included in the D24 reported figures?
6. Does the reported tax expenditure include exempt car fringe benefits? If not, what is Treasury's estimate of the tax expenditure associated with exempt car fringe benefits?
7. For each of the last ten years, please give:
  - FBT paid relating to car benefits calculated by the statutory formula method;
  - the number of employers involved;
  - the number of cars involved;

- FBT paid relating to car benefits calculated by the operating costs method; the number of employers involved; the number of cars involved.
8. What is the government's knowledge of the income distribution of the beneficiaries of the tax expenditure (ie the affected employees, assuming employers pass the benefit through)? For example, what proportion of the beneficiaries have income at a level that incurs the top marginal rate?
  9. At the time FBT was established, what was the policy purpose of making FBT of cars concessionary? Please give references to any written government policy or statement of the time supporting this.\*\*
  10. At present, what is the policy purpose of making FBT of cars concessionary?\*\*\*
  11. What is the present purpose of setting the statutory formula thresholds and percentages at the chosen numbers? If there is an assumption that the percentages reflect average amounts of work-related and private use by cars in the various kilometrage categories, what research or data supports this?
  12. What is the government's knowledge of the extent to which the concessionary aspect of car FBT, and/or the construction of the statutory formula, encourages use of cars which would not otherwise occur?\*\*\*
  13. Is there any practical or administrative impediment to changing the details of the statutory formula (for example, the number of kilometrage categories, or the statutory percentages), if the Government should wish to do so?
  14. Has Treasury done any modelling of the likely cost to revenue of these scenarios:
    - make employer-provided public transport fares to and from work an exempt benefit;
    - make employer-provided public transport fares generally a benefit taxed concessionally to the same degree that car benefits by the statutory formula method are taxed concessionally.

If so, what were the results?

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\*\* Note that whether the tax should be concessionary, and whether there should be a statutory formula method for the sake of easy compliance, are separate questions, since a statutory formula method could be maintained, but the concessionary aspect reduced, by adjusting the details of the statutory formula: see this committee's report on *Australia's Future Oil Supply and Alternative Transport Fuels* (2007), paragraphs 8.88 & 8.95, at [http://www.aph.gov.au/senate/committee/rrat\\_ctte/completed\\_inquiries/2004-07/oil\\_supply/index.htm](http://www.aph.gov.au/senate/committee/rrat_ctte/completed_inquiries/2004-07/oil_supply/index.htm)

Concerning fringe benefits taxation of vehicles other than cars:

15. For each of the last ten years, please give:

- FBT paid relating to vehicle other than car benefits; the number of employers involved; the number of vehicles involved.

16. Does Treasury believe that FBT of vehicles other than cars is concessionary? Why/ why not? If so, what is the estimated value of the tax expenditure? Does this include exempt benefits?

25 June 2009

## **Treasury's Answers:**

Concerning tax expenditure D24 relating to the concessionary taxation of car fringe benefits by the statutory formula method (2008 Tax Expenditures Statement, p163):

- 1. How are the tax expenditure amounts estimated and what are the input data used? Please give details of the data used relating to the years shown in the 2008 Tax Expenditures Statement.**

The tax expenditure amounts were calculated using the following methodology:

- The taxable value of packaging cars using the operating cost method (OCM) was considered the benchmark treatment. This was used to determine the tax that would be payable if the statutory formula method (SFM) was removed.
- The calculated forgone income tax was then compared to the current revenue attained using the statutory formula method. The difference between the two is the cost of this expenditure.

Input data included:

- FBT return from data was used to provide information on car benefits calculated using SFM and OCM.
- Individual income tax return data was used to calculate the marginal tax rates of those with reportable fringe benefits recorded.
- External data such as NRMA data was used to provide estimates on motor vehicle operating costs
- Statutory interest rates were fixed at the current level and CPI forecasts were also used.
- Other assumptions were made to account for late lodgers, private use of vehicles and growth in the number of vehicles.

### **1a. Why was there a big jump in the estimated tax expenditure between the 2006 and 2007 Tax Expenditures Statements?**

In the 2006 Tax Expenditures Statement, the estimates for this particular tax expenditure were based on assumption that if the concession did not exist, many drivers would give up their cars, reducing the estimate of revenue forgone.

Such a methodology was effectively excluding the current level of concession to those cars assumed to be ‘forgone’, and was therefore underestimating the total value of concessions applicable to the total current volume of cars using the statutory formulas.

This methodology was updated as part of the estimates presented in the 2007 Tax Expenditures Statement, which estimate the total value of concessions applicable to all cars currently utilising the statutory formulas (i.e. prior to any behaviour change). This methodology change brought its treatment into line with other tax expenditure, which in turn is consistent with methodology applied in other countries.

The updated methodology effectively removes any impact associated with the behaviour changes of individuals, and simply analyses the existing stock of concession utilisation.

### **2. What is the reliability of the estimate for past years?**

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In the 2008 TES, the reliability of this tax expenditure estimate was reported to be low. This is because it is difficult to be certain of the distance travelled by packaged cars and therefore the proportion of cars to allocate to each statutory fraction under the statutory formula method.

Some of the significant uncertainties related to these estimates are outlined below:

- Distributions of car prices/ values for which the statutory formula method (SFM) is applied, including whether there is any relationship between the value of a car and the likelihood of a particular SFM fraction being applied.
- Distributions of depreciation, insurance and registration costs for cars within each SFM range.
  - These costs are relevant to calculating the taxable value of each car under the operating cost method (OCM), and therefore relevant to the estimated cost of the concession.
- Distributions of kilometres travelled within each SFM kilometre range.
  - Per kilometre costs such as petrol and repairs/ maintenance are relevant to calculating the taxable value of each car under the OCM, and therefore relevant to the estimated cost of the concession.
- Distributions of private usage within each SFM kilometre range, as well as the average level of private usage within each range.

### **3. What is the reliability of the estimate for future years?**

- The reliability of this tax expenditure estimate for future years is also considered to be low.
  - In addition to the uncertainties noted in the response to Question 2, estimates for future years also rely on projections of the number of cars taxed using the statutory formula method.

**4. How are the amounts of actual private and work-related use by the affected cars estimated?**

No data is available on the percentage of private use for individuals using the operating cost method.

- The assumed percentage of private usage under the statutory formula method was used as a proxy for the percentage of private usage under operating cost method, which forms part of the benchmark for this TES estimate. Estimates of the percentage of private and work-related use of estimated cars are benchmarked to observed outcomes relating to the taxable value of cars reported under each method (SFM and OCM).

**5. Is taxation of cars by the operating costs method concessionary (as could be the case for example if the statutory depreciation and interest rates were out of step with true depreciation and interest rates)? If so, what is Treasury's estimate of the tax expenditure, and is it included in the D24 reported figures?**

The operating cost method is not considered to be concessional and therefore not included in TES calculation for this item.

- The operating cost method was used as the benchmark for estimating the value of concessions applicable to the statutory formula method.

**6. Does the reported tax expenditure include exempt car fringe benefits? If not, what is Treasury's estimate of the tax expenditure associated with exempt car fringe benefits?**

The estimate for this Tax Expenditure Item (Item D24 in 2008) includes exempt fringe benefits.

- Employers are required to report both exempt and non-exempt benefits on their fringe benefits tax return when reporting fringe benefits related to utilisation of the statutory formula for valuing car benefits.

**7. For each of the last ten years, please give:**

**FBT paid relating to car benefits calculated by the statutory formula method; the number of employers involved; the number of cars involved;**

**FBT paid relating to car benefits calculated by the operating costs method; the number of employers involved; the number of cars involved.**

Fringe Benefits Tax paid relating to car benefits is not able to be separately identified. The table below provides data for the 10 most recently available years related to:

(1) The taxable value of car benefits (which are then grossed-up using the Type 2 fringe benefit gross-up rate of 2.0647 to convert them to reportable fringe benefits and then taxed at the FBT rate of 46.5 per cent where the fringe benefit is not subject to an exemption);

(2) The number of employers involved; and

(3) The number of vehicles involved.

For both the Statutory Formula Method (SFM) and Operating Cost Method (OCM) of valuing car fringe benefits.

Year	Statutory Formula Method (SFM)			Operating Cost Method (OCM)		
	Taxable Value (\$m)	No. of Employers	No. of Vehicles	Taxable Value (\$m)	No. of Employers	No. of Vehicles
<b>1998-99</b>	1,530	48,675	607,252	110	17,855	99,777
<b>1999-00</b>	1,577	46,940	587,622	116	18,030	127,558
<b>2000-01</b>	1,880	43,570	773,541	141	17,735	1,609,476
<b>2001-02</b>	1,593	41,985	1,521,821	135	17,730	1,100,391
<b>2002-03</b>	1,567	40,790	751,330	136	17,745	515,695
<b>2003-04</b>	1,598	40,380	3,309,166	145	18,030	869,783
<b>2004-05</b>	1,644	39,565	1,185,103	147	18,215	3,048,735
<b>2005-06</b>	1,674	38,490	758,689	151	18,005	1,450,932
<b>2006-07</b>	1,658	37,215	958,687	151	17,215	1,126,405
<b>2007-08</b>	1,594	34,600	977,190	144	15,675	1,156,179

Note: Taxable value and number of employer figures are sourced from FBT Table 7B of 2006-07 Taxation Statistics.

Figures for the number of vehicles are sourced from FBT Table 6B of 2006-07 Taxation Statistics. However, as incorrect reporting of the number of vehicles provided by businesses does not impact upon FBT outcomes (which are calculated on the basis of taxable values reported, with no calculation link back to the number of

vehicles provided), we believe that the figures reported for the number of vehicles provided cannot be considered reliable.

**8. What is the government's knowledge of the income distribution of the beneficiaries of the tax expenditure (ie the affected employees, assuming employers pass the benefit through)? For example, what proportion of the beneficiaries have income at a level that incurs the top marginal rate?**

As fringe benefits related to cars are reported at an employer level and reportable fringe benefits for each affected individual are not disaggregated by type, no administrative data is available on which to estimate the taxable income distribution of affected employees.

**9. At the time FBT was established, what was the policy of making FBT of cars concessionary? Please give references to any written government policy or statement of the time supporting this.**

The original purpose of the statutory method for valuing car fringe benefits was to apply tax to the private use of the vehicle, not its use for work purposes, and distance travelled was used as a proxy for the proportion of business travel. It was designed to provide employers with a low compliance cost alternative to the operating cost method, eliminating the need to maintain a vehicle log book, and introduced in 1986.

While the statutory method does not explicitly distinguish between business and private use of a vehicle, because a significant proportion of cars provided as fringe benefits will have some business use, the statutory formula effectively incorporates a business use element into the valuation of the benefit. This implicit business use element increases with the annual distance travelled by the vehicle, such that the FBT payable decreases. The actual concessionality of the statutory formula method for each taxpayer would depend on their individual circumstances but the rates were based on assumptions of average use at the time of introduction.

The statutory formulas were amended (the statutory percentage was lowered for people travelling more than 15,000 kms per year) as a result of discussions with the Australian Democrats, in order to secure the passage of the original FBT Act, making the rates more concessionary and therefore not necessarily reflective of assumptions of average use at that time.

**10. At present, what is the policy purpose of making FBT of cars concessionary?**

The policy of the FBT statutory formula for valuing car benefits is set out in Chapter 13 of the Australia's Tax System Review Consultation Paper of December 2008.

An employees private use of a taxi, panel van, utility or other commercial car is exempt from FBT in certain circumstances (for example, travel between work and home and minor non-work-related use), due to compliance cost savings.

**11. What is the present purpose of setting the statutory formula thresholds and percentages at the chosen numbers? If there is an assumption that the percentages reflect average amounts of work-related and private use in the various kilometrage categories, what research or data supports this?**

The current statutory formula percentages were set in 1995. The changes in 1995 increased the rates for all distances travelled. The changes reduced concessionality, but made no changes to the underlying assumptions.

In the second reading speech, the then Assistant Treasurer Mr George Gear, MP, stated:

“In order to maintain the revenue neutrality of this package of compliance cost reduction measures, the bill will increase the statutory fractions used in the statutory formula for car benefits by approximately 10 per cent. Even with these increases in the statutory fractions, the statutory formula will remain significantly concessional under a wide range of circumstances. This amendment is estimated to raise \$121 million in 1995-96 and \$91 million in each later year.”

No data is available on the percentage of private use for individuals using the operating cost method.

The assumed percentage of private usage under the statutory formula method was used as a proxy for the percentage of private usage under operating cost method, which forms part of the benchmark for this TES estimate. Estimates of the percentage of private and work-related use of the estimated number of cars are benchmarked to observed outcomes relating to the taxable value of cars reported under each method (SFM and OCM).

**12. What is the government's knowledge of the extent to which the concessionary aspect of car FBT, and/or the construction of the statutory formula, encourages use of cars which would not otherwise occur?**

The extent to which current utilisation of cars valued using the statutory formula method (SFM) is driven by the concessional taxation treatment applicable under this formula is unknown and uncertain. However, there is some discussion about these issues in Chapter 13 of the Australia's Tax System Review Consultation Paper of December 2008 and in the Review of Australia's Automotive Industry undertaken by the Hon Steve Bracks.

There are two primary groups for whom the current construction of the statutory formula will have minimal (if any) impact on their use of cars. These groups are as follows:

(1) Employees who are provided with a car as part of an employment contract and have no discretion in terms of opting in or out of packaging a car within their remuneration agreement; and

(2) Employees for whom the SFM and the operating cost method (OCM) provide similar taxation liability outcomes (typically where the percentage of business use is quite high), but for whom the SFM involves a much simpler calculation of the tax liability.

No administrative data is available to estimate the size of each of the groups noted above relative to the total group of employees utilising the SFM.

**13. Is there any practical or administrative impediment to changing the details of the statutory formula (for example, the number of kilometrage categories, or the statutory percentages), if the Government should wish to do so?**

There is no legislative impediment to changing the elements of the statutory formula. The nature of any practical impediments would be dependant on the nature of the proposed change.

**14. Has Treasury done any modelling of the likely cost to revenue of these scenarios:**

- **make employer-provided public transport fares to and from work an exempt benefit;**
- **make employer-provided public transport fares generally a benefit taxed concessionally to the same degree that car benefits by the statutory formula method are taxed concessionally.**

**If so, what were the results?**

Treasury has not specifically modelled potential costs to revenue for making employer-provided public transport fares to and from work an exempt benefit, or making it a benefit taxed concessionally.

TES Item D16 'Exemption for free or discounted commuter travel for employees of public transport providers' gives expenditure estimates for what is essentially a subset of taxfilers. Subsection 47(1) of *Fringe Benefits Tax Assessment Act 1986* provides details for this exemption:

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- Where an employer operates a business of providing transport to the public, the provision of free or discounted travel (other than in an aircraft) to employees of that business for the purpose of their travelling to and from work is exempt from fringe benefits tax.
  - Where an employee's place of work is in a metropolitan area, free or discounted travel on a scheduled service within that area is also exempt from fringe benefits tax.

It is estimated that this exemption leads to revenue forgone of \$25 million per annum from 2009-10.

### **Concerning fringe benefits taxation of vehicles other than cars:**

**15. For each of the last ten years, please give:**

**FBT paid relating to vehicle other than car benefits; the number of employers involved; the number of vehicles involved.**

The value of fringe benefits tax collected in relation to vehicles other than car benefits, the number of employers involved and the number of vehicles involved are all unquantifiable, as this type of fringe benefit is not separately identified on fringe benefits tax returns submitted by businesses.

**16. Does Treasury believe that FBT of vehicles other than cars is concessionary? Why/ why not? If so, what is the estimated value of the tax expenditure? Does this include exempt benefits?**

The value of fringe benefits tax collected in relation to vehicles other than car benefits, the number of employers involved and the number of vehicles involved are all unquantifiable, as this type of fringe benefit is not separately identified on fringe benefits tax returns submitted by businesses.

