

Submission to the National Tax Forum

The Australian Salary Packaging Industry Association (“ASPIA”) represents Australia’s benefit remuneration industry.

The Association is privy to all benefit remuneration practices, theories and initiatives currently operating within the Australian marketplace and therefore should be considered an invaluable point of reference in any effort to better understand and plan for the challenges and opportunities presented by Australia’s benefit taxation framework.

Submission summary

- Australia’s **benefit taxation rules are a powerful tool** for influencing individual employee behaviour;
- Benefit concessions for specific benefit or employee categories should be considered in the upcoming Forum as **an effective way to promote public policy goals**;
- The Henry Review recommendation to move benefit taxation into the individual PAYG system **should not dilute the application of current benefit concessions**, as doing so would have a detrimental impact on Australian employers, employees and business;
- The Henry Review **recommendation to abolish the benefit concession for Public Hospitals and not-for-profit employers should be rejected** as per the commitment made by the current Labor government in its official response to the Review; and
- Forum delegates should recognise the effectiveness of benefit taxation rules as a policy tool, and should consider their potential in pursuing national policy goals, particularly in the areas of **environment**, support for the **not-for-profit sector** and **regional and remote area employment**.

Submission detail

This submission provides ASPIA’s views in relation to:

1. the challenges and opportunities presented by benefit taxation within Australia;
2. the potential impact of proposed legislative changes around benefit taxation on individual Australian employees and employers; and
3. the key priorities that policymakers should consider when planning for the future.

ASPIA’s comments in this regard have primary relevance to Session 1 of the National Tax Forum: Personal Tax.

1. **Benefit Taxation: Current Challenges and Opportunities**

Australian employees are active participants in Australia’s salary structuring and packaging marketplace. Tax concessions and exemptions aimed at specific products and services (or for particular employee expenditure) generally have a direct and material impact on the consumer and personal behaviour of Australian employees.

For example the exemption for pre-tax superannuation contributions acts as a very significant driver for increased superannuation savings, just as the fringe benefits tax (“FBT”) concession for company-provided cars has a long-recognised impact on employee driving behaviour.

Benefit taxation rules are thus more than a simple source of government revenue: they are an effective tool for achieving policy outcomes.

Furthermore, an established and effective mechanism already exists to efficiently translate tax-based initiatives into widespread behaviour-change amongst Australia's employee base. The Australian salary packaging industry possesses both the knowledge and experience to explain benefit-based tax concessions to employees in a simple and effective way, and therefore to facilitate behaviour consistent with policy objectives.

That is, the salary packaging industry already exists as an effective (and privately funded) tool through which policy objectives are promoted and amplified throughout Australia's employee marketplace.

In this regard benefit taxation rules have a clear potential to effectively deliver real benefits to Australian communities in areas such as:

- Encouraging the purchase and use of **low-emission, environmentally friendly vehicles**;
- Encouraging the use of **public transport** and other "green" transport options; and
- Supporting our **charity and public hospital sector**.

All that is required is the will and initiative to embrace this policy mechanism as a means to achieve positive outcomes for Australia. The abolition of employee benefit concessions in pursuit of short-term (and questionable) revenue gains, or in favour of a more academically "pure" model of taxation, is as impractical as it is short-sighted.

Instead of seeking to limit benefit taxation as an unnecessary complexity, Australia should embrace and extend this tool as a powerful and effective means of pursuing public policy.

2. Benefit Taxation: Proposals for change

The Australia's Future Tax System Review ("the Henry Review") made two significant recommendations in relation to the way Australia taxes employee benefits, both of which appear to have been tabled for discussion at the National Tax Forum.

Those recommendations are:

1. **Recommendation 9**: "Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system"; and
2. **Recommendation 43**: The benefit concessions for not-for-profit employers should "be phased out over ten years" and "be replaced with direct government funding"

Each recommendation raises its own set of challenges, and each has the potential to significantly impact Australian employer and workers.

This submission does not seek to analyse those challenges in detail – the Forum itself is the appropriate venue for this – but does seek to highlight key points that should be considered by delegates in any discussion of these benefit taxation issues.

2.1 Henry Review Recommendation 9: Tax benefits within the PAYG system

The Henry Review has recommended "simplification" of the employee benefit taxation system with the ultimate goal of including the value of employee benefits in individual income tax returns.

This recommendation does not, of itself, argue for the wholesale removal of benefit concessions and thus would presumably seek to retain these in their present form. Any initiative to bring fringe benefits into the income tax regime must, however, carefully consider the following:

- Concessional elements attached to current benefit taxation rules must be preserved in order to avoid deleterious impact on both employees and Australian industry;
- Fringe benefits are currently taxed at the top marginal rate - taxing benefits at individual marginal rates will result in a loss of overall tax revenue;
- The administration relating to valuation and taxation of employer-provided benefits is complex – shifting this burden to individual taxpayers will result in more complicated personal tax returns;

- Administration/enforcement costs relating to benefit taxation are likely to increase significantly given that the taxable amounts will be spread across a much larger group of taxpayers; and
- Any move to make fringe benefits taxable in the hands of individuals should consider contractors and sole practitioners in addition to PAYG employees to ensure that all Australians remunerated through benefits are taxed on the same basis.

2.2 *Henry Review Recommendation 43: Concession for not-for-profit employers*

The Henry Review also recommended the “reconfiguration” of the not-for-profit concessions that allow Public Hospital and Charitable employers to remunerate employees with tax-free benefits (up to a prescribed threshold).

The Review suggested this benefit concession be abolished and replaced with “direct government funding” to compensate affected Public Hospitals and Charities for the impact removal of this concession would have on their remuneration costs.

This recommendation was very unpopular with Australian taxpayers and was not well received for a number of reasons:

- Public Hospitals and Charities rely on benefit concessions to offer a competitive remuneration package to prospective employees.
- The direct government funding process is uncertain, time consuming and unreliable means of obtaining funds to remunerate employees; and
- The proposal is unlikely to lead to any revenue savings given that the increased cost of “direct funding” could very easily exceed the cost of the current benefit concession.

The undesirability of this proposal was recognised by the Labor Government in its 10 May 2010 press release where it set out its agenda in response to the Henry Review. At that time the Labor Government listed recommendation 43 as one that, “in the interests of business and community certainty, the Government advises that it will not implement . . . at any stage.”

It is therefore somewhat disappointing, and confusing, to see this recommendation being considered again on page 10 the Discussion Paper for the upcoming Forum.

3. **Benefit Taxation: Key priorities going forward**

As already noted in this submission, benefit taxation rules are an efficient and effective tool for driving/encouraging individual behaviour within the Australian community.

At the moment ASPIA receives regular feedback around the lack of tax-based incentives for the following employee behaviours:

- Public transport;
- Personal health;
- Bicycle travel to and from work;
- Living and working in remote areas; and
- The purchase and use of low-emission vehicles.

All of the above opportunities fit within current Australian Government policy priorities, and **all could easily and effectively be promoted through benefit concessions** for Australian taxpayers.

A number of submissions to the Henry Review identified these opportunities and included detailed explanations and examples of how benefit concessions could be used to further promote public policy goals. This submission does not seek to reproduce those details, but includes several of the relevant submissions in the Appendix.

Nevertheless a key priority for the upcoming forum, and indeed all future taxation reviews, must be the retention of benefit concessions and a focused analysis on how they can best be used as a tool to deliver real progress in relation to the national agenda.

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Appendix

The following submissions to the Australia's Future Tax System Review are attached as an Appendix:

- Australian Conservation Foundation
- Catholic Health
- National Disability Services
- Smartsalary
- Australian Fleet Managers Association
- Mc Millan Shakespeare
- The Salvation Army
- The Federal Chamber of Automotive Industries

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1 May 2009

Supplementary submission to the review of Australia's future tax system

This submission sets out the additional views of the Australian Conservation Foundation (ACF) on the Consultation Paper on Australia's future tax system. ACF's original submission to the review, dated 30 October 2008, addresses several sections of the Consultation Paper in detail, particularly 12 (Fuel, Roads and Transport), 13 (Impacts on the Environment) and 14 (Natural Resource Charging).

This submission provides some additional information on the environmental impacts of the fringe benefits tax (issue 13), and some views on the taxation of not-for-profit organisations (issue 7). We would be pleased discuss further any of the ideas and concepts outlined in this submission.

Summary

1. Fringe Benefits Tax Reform

The FBT statutory fraction for company cars should be based on the Green Vehicle Guide rating for the vehicle, rather than distance driven per year. Economic modelling shows that such a shift would reduce emissions from new vehicles by at least 20%, be revenue-positive, and would support transition of domestic production to cleaner vehicles.

2. Not-for-profit organisations

ACF is broadly supportive of the current system of NFP tax concessions. The system could be improved by:

- Consolidating the number of categories of NFPs (provided that existing NFPs are not subject to a reduction in entitlements);
- Reducing compliance costs by eliminating duplicative procedures, such separate assessments of charitable status by numerous state and federal authorities;
- Establishment of a national regulator for the NFP sector; and
- Retention of tax concessions as the primary form of support for NFP sector, as a more efficient and desirable than other forms of direct support, such as government grants.

1. Fringe Benefits Tax reform

Q13.2 Noting that many submissions raise concerns over unintended environmental consequences of taxes and transfers, such as the fringe benefits tax concession for cars, are there features of the tax-transfer system which encourage poor environmental outcomes and how might such outcomes be addressed?

As noted in the consultation paper, there is widespread concern that the way in which company car benefits are valued for FBT purposes provides an incentive for personal vehicle use over other modes of transport, and encourages excessive driving. ACF's analysis of the issue is contained in Section 5 of our original submission.

Since our original submission, additional work has been conducted on the implications of restructuring the FBT rule, so that the statutory fraction applicable to a company car benefit is based on the efficiency of the vehicle, rather than the distance driven per year.

The Australian Government Green Vehicle Guide¹ provides a useful existing benchmark for such a reform. The following table is an example of how this reform could be implemented.

Kilometres driven	FBT statutory fraction
Less than 15,000	26.0%
15,000-24,999	20.0%
25,000-40,000	11.0%
More than 40,000	7.0%

Current formula encourages excessive driving...

Green Vehicle Guide Rating	FBT statutory fraction
4 - 5 Stars	7.5%
3.5 Stars	12.0%
3 Stars	20.0%
Less than 3 Stars	24.0%

...reform based on green vehicle guide rating would reward efficiency.

According to modelling conducted by Access Economics and commissioned by McMillan Shakespeare Australia (Australia's largest salary packaging company), tying FBT concessions to the Green Vehicle Guide star rating system would shift car purchasing decisions towards more efficient vehicles, resulting in a 20% reduction in greenhouse emissions from new vehicle fleets. Additional reductions are likely to the extent that the reforms result in fewer average kilometres per vehicle per year.

The modelling also shows that this reform would result in a net positive impact on government revenue of \$186 million annually, and would have minimal negative impact on domestic manufacturing. Based on the current production mix for domestic and foreign vehicles, the proposed reform could reduce demand for domestic vehicles from 1.1 % - 1.7%.

However, a shift to production of efficient vehicles, as all Australian manufacturers are planning, will reduce or eliminate even that minor impact. Efforts to re-tool the Australian car industry for cleaner vehicle include a significant Commonwealth investment through the Green Car Innovation Fund. Of the Australian manufacturers, Ford has announced it will begin production of a small car in Melbourne from 2011, Toyota will commence Camry hybrid production in Australia in 2010, and Holden will produce a

¹ www.greenvehicleguide.gov.au

small car in Adelaide from 2010. FBT reform will help drive market demand for this new generation of domestically-produced efficient cars.

FBT reform would have administrative benefits as well. Currently, assessment of FBT rates entails significant burdens, as drivers must maintain records of fuel purchases each year. A regime based on the green car rating requires no ongoing record-keeping burden, thus simplifying the tax system for taxpayers and the ATO alike.

The submission of McMillan Shakespeare Australia to the Review includes the economic modelling by Access Economics referenced above. It is our understanding that Salary Smart, another major salary packaging company, is supportive of this reform in principle as well, based on their submission to the Review.

2. Not-for-profit organisations

Q7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

Q7.2 Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

ACF supports the overall system of tax concessions for NFP organisations. These organisations play a critical role in civil society, and support through the tax system is an appropriate and generally efficient way to foster philanthropy a culture of philanthropy, public service and community engagement that individuals who support NFPs epitomise.

There are, however, areas where improvement of the system is desirable. The current structure can create unnecessary complexity and compliance costs, particularly through the proliferation of categories of NFPs and through a lack of inter- and intra-governmental coordination on tax issues relevant to NFPs. The establishment of a national regulatory body for NFPs would assist in ensuring ongoing efficiency and effectiveness of NFP regulation.

While the administration of the existing concessions can be improved, replacement of existing concessions by other means (such as direct grants) would generally not be a more efficient way of assisting NFP organisations. Grants would entail significantly higher administrative costs for NFPs and governments alike, would reduce certainty of funding, and could have serious adverse consequences for the independence of NFP organisations from governments.

2.1 Simplification of categories of NFP organisations

As noted in the consultation paper, there are numerous categories of NFP organisations. At the Commonwealth level, distinctions are made among deductible gift recipients (DGRs), income-tax exempt charities (ITECs), public benevolent institutions (PBIs), community service organisations (CSOs), and an array of sub-categories within each of these. When various state categories are added, the list grows further.

It would appear that the types of organisations and the entitlements for each have developed organically over time, with little apparent rationale behind the distinctions between them. There is substantial overlap between some categories, with associated administrative duplication and complexity.

There appears to be a good case for rationalising the number of categories of NFP organisations, provided that such a process would not reduce the entitlements that current NFPs can access. For example, it may be desirable to combine the categories of DGR, ITEC and PBI into a single category of “charity”, with the benefits of each of those three separate categories accruing to all qualifying “charities”.

2.2 *Reduction in compliance costs*

There is currently no central regulator or coordinating body for regulation of the not-for-profit sector in Australia. With respect to taxation, the lack of coordination among state and federal agencies can impose significant regulatory burdens for little discernable benefit.

For example, a major review conducted on behalf of the National Roundtable of Nonprofit Organisations, “The Assessment of Charitable Status in Australia, identified 178 pieces of legislation under which a NFP’s status as a charity has to be determined, and no fewer than 19 government agencies at Commonwealth and State levels (including the ATO and state revenue agencies) that are regularly involved in making those determinations. Each of these 19 has its own processes, forms and evidentiary requirements. Each undertakes its own assessment of an entity’s status as a charity, even though the legal test is identical. On occasion, they reach inconsistent results, or conduct separate reviews with little or no coordination with other authorities.

The ACF’s experience under this system is instructive. The Commonwealth recognised ACF as a charity in 1970, but ACF has had to apply separately to each state revenue office for recognition as a charity as well, for state tax purposes.

Notwithstanding the Commonwealth recognition of ACF as a charity, Victoria initially refused to accord ACF charitable status. This led to a legal challenge, culminating in a legal challenge that resulted in ACF being recognised as a charity for purposes of the Victorian Payroll Tax Act in 2002.²

The process entailed an exhaustive examination of the ACF’s Constitution, purpose and activities, and resulted in a decision that ACF was a charity under the common law, and was therefore entitled to the payroll tax concessions.

Only three years later, ACF was faced with yet another review of its charitable status by the Australian Taxation Office, as part of the ATO’s ongoing compliance program. The review covered the same ground as the Victorian process, and reached the same conclusion. Each process consumed many dozens of hours of staff time, including significant senior management attention.

Of course, none of these processes was in any sense improper, yet it is unclear what was gained by having two regulators examining the same substantive question in such detail within such a relatively brief timeframe. A system of a single national determination of charitable status would have served all involved much better.

2.3 *Establishment of a NFP national regulatory body*

The National Roundtable of Nonprofit Organisations has for many years called for reform to address the numerous, inconsistent and overlapping laws and agencies regulating the not-for-profit sector, particularly in relation to taxation law³. Most recently the case for establishing a national NFP regulator, with responsibility for determining charitable status (amongst other things) was made by many during the recent Senate enquiry into NFP disclosure regimes, and is one of the principal recommendations in

² Australian Conservation Foundation Inc v Commissioner for State Revenue Victoria [2002] VCAT 1491

³ See National Roundtable of Nonprofit Organisations – Nonprofit Regulation Reform Program – May 2004 (http://www.nonprofitroundtable.org.au/Content/NavigationMenu2/PolicyRegulatoryReform/documents2/Reg_Ref orm-Statement.pdf)

the Committee's report⁴. ACF strongly supports that recommendation, and the establishment of a national regulator would greatly facilitate the resolution of the regulatory inefficiencies described above, among others.

2.4 The efficiency of current NFP tax concessions, compared to direct grants or other support

Governments are, understandably, geared to pursuing a particular agenda, derived from the political process. The purpose of civil society, on the other hand, is to constitute an independent source of strength within society, which is at once able to give expression to a diversity of viewpoints and priorities, including priorities not shared by the government of the day, and also to be an independent check and source of accountability for governments.

Frequently there will be constructive cooperation between governments and NFPs on a wide range of issues. However, the potential for differences can not be ignored, and there will always be the possibility of tension or even conflict between the desires of government to prosecute their agenda, and the role of NFPs in pursuing other priorities and monitoring government performance.

In this regard, the temptation for governments to utilise grant agreements or other forms of support as points of leverage and influence on NFPs can not be disregarded. For example, governments may be inclined to refuse grants, or to attach onerous conditions to such grants, for NFPs that have been critical of the government.

Of course, this is a possibility for benefits such as tax concessions as well, but in practice grant programs can be used as pressure points on nonprofit organisations much more readily than tax rules, which generally provide entitlements of broad applicability that are much more difficult to change. It is instructive that many Commonwealth grant agreements up until 2008 included "non-advocacy clauses", which prohibited recipients from engaging in critical communications.

The ability of governments to attach conditions to grants stands in stark contrast to the requirement that charitable donations be made unconditionally. As a consequence, indirect forms of funding such as the existing NFP tax concessions provide organisations with far more freedom to set their own agendas and develop more appropriately targeted programs than would otherwise be the case.

Freedom from government interference (both real and perceived) is particularly important for advocacy organisations whose reputations are built on an ability to comment openly on government policy. Increased reliance on government funding diminishes an advocate's effectiveness and places it at constant risk of 'biting the hand that feeds it'. It is an invidious position and one that many leading advocate organisations actively resist for good reason.

Furthermore, one of the major advantages of the current NFP tax concessions is the extent to which they minimise the cost and time associated with compliance (although there is scope for improvement, as outlined above).

Removing existing NFP tax concessions in favour of more direct forms of funding would undoubtedly create new and unwelcome administrative burdens for NFPs and governments alike. In order to be effective, such a system would require significantly improved cooperation and coordination between government departments at all levels, something our federal system has always found difficult to achieve. For example, a recent study by the Centre of Philanthropy and Non Profit Studies revealed major inconsistencies between funding application and acquittal documentation across (and sometimes

⁴ Senate Standing Committee of Economics – Disclosure regimes for charities and not-for-profit organisations. December 2008 (Recommendation 3)

even within) various government departments, including numerous differences in the required accounting and reporting standards⁵.

The extent to which direct funding programs can achieve their stated aims is also largely dependent on the extent to which they are effectively promoted. Organisations that may be eligible for funding can easily miss out due to ineffective promotion and inflexible deadlines. Furthermore, strict eligibility criteria can encourage the 'shoehorning' of worthy initiatives into unsuitable programs, which in turn undermines both the project and program alike.

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The Australian Conservation Foundation is committed to achieve a healthy environment for all Australians. We work with the community, business and government to protect, restore and sustain our environment.

⁵ Centre of Philanthropy & Non Profit Studies (QUT): *How long is a Piece of Red Tape? The Paperwork Reporting Costs of Government Grants* (2008).



Submission to the Review of "Australia's Future Tax System" - (Henry Review)

1. EXECUTIVE SUMMARY

This submission is made by Catholic Health Australia (**CHA**) and Catholic Social Services Australia (**CSSA**) with the technical assistance and support of McMillan Shakespeare Limited (**McMillan Shakespeare**).

This submission addresses issues only in relation to fringe benefits tax for Not-For-Profit Organisations. That is, not for profit charity social services and not for profit health services (**NFPO**).

The Review was requested to consider the fairness of the existing FBT regime for the NFP sector in the Consultation Paper¹ issued in August 2008:

The Australian Government has asked the Review Panel to examine the complexity and fairness of existing FBT arrangements for the not-for-profit sector, and the treatment of fringe benefits in other parts of the tax-transfer system, and to make recommendations to improve equity and simplicity for the long term.

Our submission specifically addresses the questions raised in the review's Consultation Paper² issued in December 2008:

- Q4.5 *Should people in different circumstances be taxed differently (for example, by age, occupation, location), and what might be the implications of such arrangements? Are tax offsets the best way to achieve differential taxation?*
- Q4.6 *How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?*
- Q7.1 *What is the appropriate tax treatment for NFP organisations, including compliance obligations?*
- Q7.2 *Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?*

¹ Architecture of Australia's tax and transfer system, August 2008 (page 25)

² Australia's future tax system Consultation paper December 2008

Historically, fringe benefits tax concessions for NFPO have greatly assisted employers to attract and retain staff. However, over the years since year 2000, the benefit derived by employees who elect to salary package has been progressively eroded. Inflation and wage adjustments have grown in excess of 30% and 35% respectively, whilst the FBT concession has remained unchanged (non indexed).

The sector very much values the FBT concession as a method of helping to retain and attract labour with improved remuneration offerings for its employees. The current FBT concessions have been used responsibly by employers.

We have examined and debated both internally and externally over many years the merits of retaining the FBT concessions versus other options such as general pay increases for all 1.2 million employees in the sector.

On balance, we argue in this submission a case to retain and index the current FBT concessions - keep the status quo. The NFPO sector is vital to the Australian economy and for the delivery of critically important social and health programs. For example, Catholic Health operates 21 public hospitals, 54 private hospitals and 550 aged care services throughout Australia, Catholic Social Services Australia has 66 member organisations assisting in the order of 1 million Australian each year.

The NFPO sector is confronted with the challenge of too few professionals (health and social welfare), creating critical skills shortages that adversely impact service delivery, whilst at the same time finding it very difficult to retain staff. Attracting and retaining labour is a critical issue that confronts all employers in this sector.

The broad NFPO sector employs approximately 1.2 million people. The working conditions and challenges in many of the institutions within the sector are at times unattractive to say the least.

The reality is, that to abolish FBT concessions and replace them with any of the options (rebates, grants, pay rises) we have canvassed in this submission, will increase the cost significantly for government. All employees will need to be included in any such arrangements and not just the 65% that have elected to participate today. We have estimated that the additional/extra cost of abolishing the current FBT concessions with grants, rebates, full wage parity or similar will be in excess of \$2.25 billion per annum. This cost will grow each year in line with inflation and or wages growth.

We argue, on balance, that the current FBT concessional arrangements should be retained. The FBT concession should be indexed each year.

(Catholic Health Australia has argued previously for the cap on FBT to be raised in the health setting. For more information please see the Catholic Health Australia pre-budget submission at <http://www.cha.org.au/site.php?id=1749>)

2. BACKGROUND (THE CURRENT OPERATING ENVIRONMENT OF THE NFPO SECTOR)

- 2.1 Salary packaging greatly assists government employers (public hospitals), charities and the not for profit employers to attract and retain staff in the face of better terms and conditions in the private sector and other sectors. It is highly valued by employees and is recognised as some compensation for working and contributing in this very important sector.
- 2.2 Public Benevolent Institutions (PBIs) (charity social services) and not for profit (including public hospitals) receive FBT concessions from the government. Approximately 1.2 million employees are entitled to access these concessions. The current estimated participation rate is about 65%.

Employer Type	Concession	Maximum Expenditure (payments NOT subject to GST e.g. mortgage payments)	Maximum Expenditure (payments subject to GST e.g. fuel expenditure)
PBI charity social services	\$30,000 of grossed up value exempt from FBT	\$16,050	\$14,530
Public Health and not for profit health	\$17,000 of grossed up value exempt from FBT	\$9,095	\$8,234

- 2.3 The PBI charity welfare and public not for profit health sectors (**NFPO**) have expressed the following views about the FBT concession that applies³:
- It is the major tool for attracting and retaining staff in this very difficult and challenging sector;
 - The concession limit should be indexed on an annual basis (has not changed since 2000);
 - Salary packaging is a method of supplementing remuneration who are extremely low paid but expected to be highly skilled; and
 - The funding by Government is not sufficient to pay all staff full market rates and salary packaging is used as a sensible; practical and efficient way of increasing overall reward (remuneration) compensation.
- 2.4 The use of the FBT exemption is a significant tool for NFPO to attract and retain staff. This sector is under extreme pressure and will continue to be under increasing pressure over the next ten years to twenty years because of the aging Australian population, skills shortages and changing demographics.
- 2.5 The concessions have not been changed since their introduction in year 2000 despite inflation increasing in excess of 30% and minimum wage increase of over 35%.

³ Hansard for the Senate Standing Committee On Finance And Public Administration, Reference: Families, Housing, Community Affairs and Indigenous Affairs and other Legislation Amendment (2008 Budget and Other Measures) Bill 2008 on 20 June 2008

2.6 There are many misconceptions about salary packaging in NFPO. The facts are that⁴:

- The majority of employees who salary package are low and middle income earners, earning between \$30K-\$60K pa.
- 48% of participating employees in the PBI sector earn between \$20,000 to \$30, 000 per annum; and
- 80% of participating employees in the PBI sector earn less than \$50,000 per annum.

2.7 There are a number of factors that the require the government to increase support not-for-profit sector including⁵:

- The impact of the global financial crisis which has resulted in an increase in demand for services;
- The labour demands and skill shortages; and
- The substantial demographic changes expected over the next 10-20 years.

2.8 Four primary social service provider networks in Australia are :

- Anglicare Australia
- Catholic Social Services Australia
- Salvation Army
- UnitingCare Australia

2.9 In November 2008, the report on the effect of the global financial crisis commissioned by the primary social services providers (Anglicare Australia, Catholic Social Services Australia, Salvation Army and Uniting Care Australia) group and prepared by Access Economics was published. The Report⁶ stated:

The demand for social services is already rising and will rise substantially in the short-term. In many areas — examples include residential aged care, housing, homelessness and family relationship services — demand already outstrips the capacity of agencies to offer assistance. The services most immediately affected by deteriorating economic conditions are in employment, housing, financial and general counseling and emergency relief.

In addition to being the response of a genuinely civil society, high quality, social services are an integral part of a productive economy. Investment in such services is a benefit not just to those in such desperate need of services, but also reduces long term social costs and enhances the

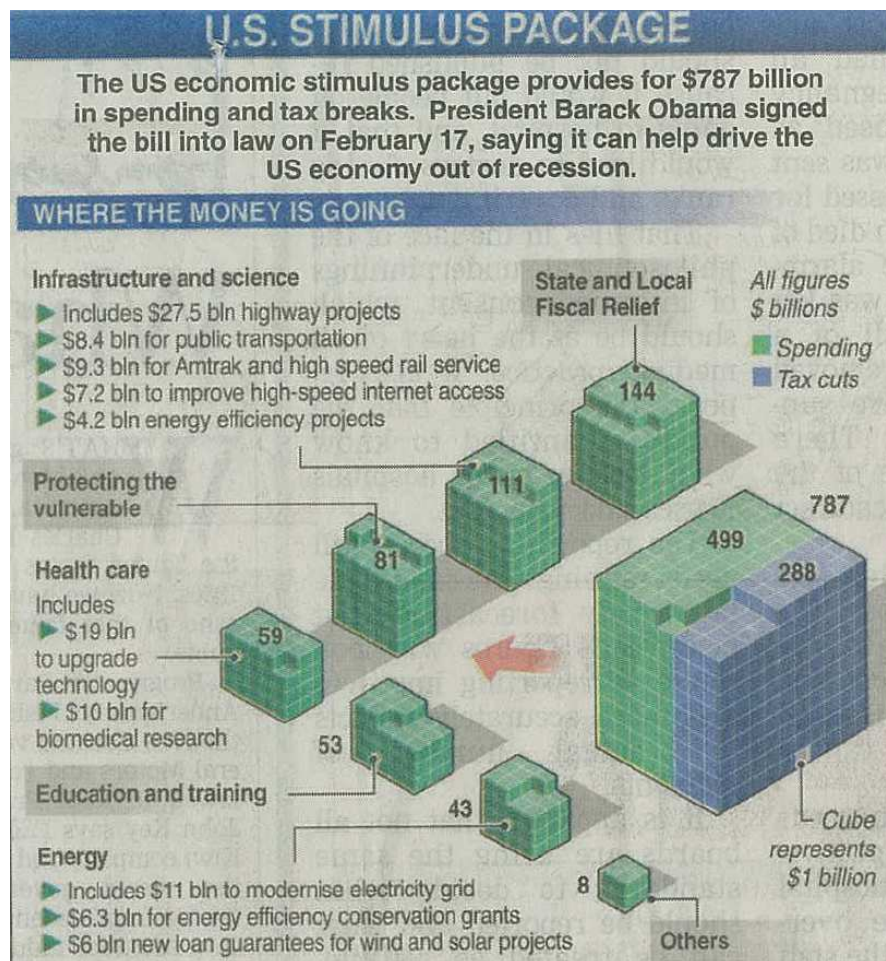
⁴ Hansard for the Senate Standing Committee On Finance And Public Administration, Reference: Families, Housing, Community Affairs and Indigenous Affairs and other Legislation Amended (2008 Budget and Other Measures) Bill 2008 on 20 June 2008

⁵ See Industry Skills Council report (ANTA) May 2005

⁶ The impact of the global financial crisis on social services in Australia – Access Economics

overall productivity of the economy. Investment in social services and social infrastructure should therefore be considered as an essential part of further fiscal stimulus measures. Long term structure change and assistance by the NFPO Sector requires and investment into skills (people) and improving remuneration is a critical starting point.

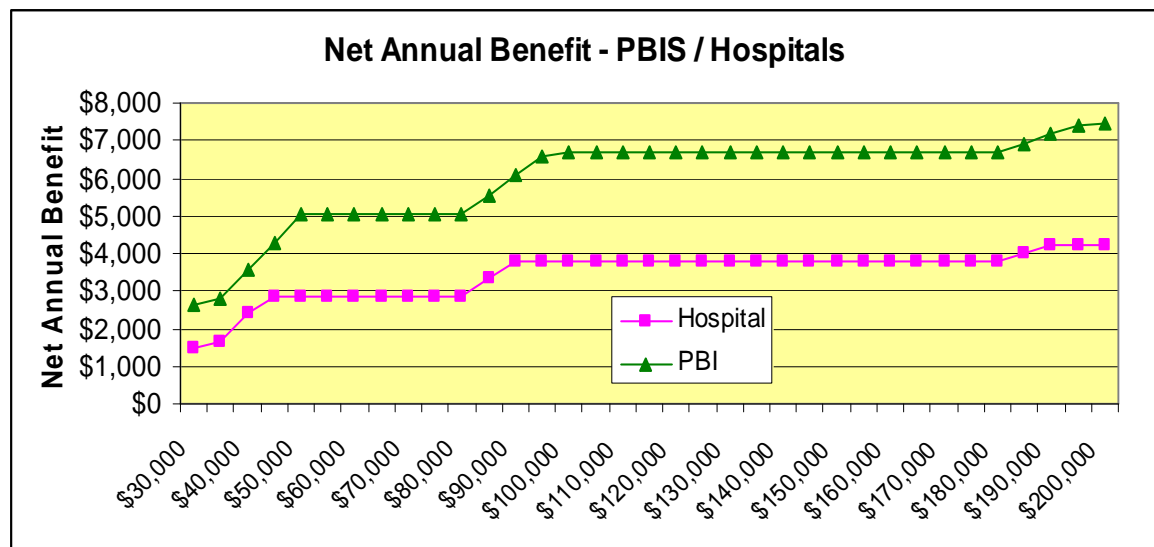
2.10 In the United States the economic stimulus package announced in February 2009 included spending of \$81 billion for protecting the vulnerable and almost \$30 billion for health care. That is almost 20% of the United States spending allocation in their stimulus package. In addition \$53 billion was allocated to education and training. To date there has been no comparable “package” or direct assistance anywhere near that recently announced by the United States.



2.11 The following table illustrates the maximum net benefit that any employee earning \$50,000 per annum can receive by salary packaging their mortgage payment up to the maximum allowable amount.

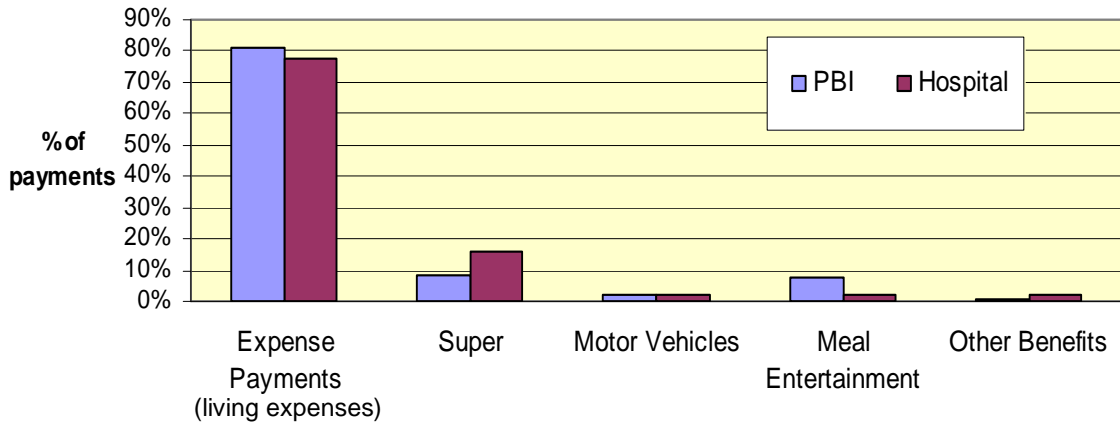
Item	Hospital		PBI	
	No Packaging	Packaging	No Packaging	Packaging
Salary	\$50,000	\$50,000	\$50,000	\$50,000
Mortgage Payments	\$0	-\$9,095	\$0	-\$16,050
Fringe Benefits Tax	\$0	\$0	\$0	\$0
Net Salary	\$50,000	\$40,905	\$50,000	\$33,950
Tax & Medicare	-\$9,750	-\$6,885	-\$9,750	-\$4,702
Net Cash Salary	\$40,250	\$34,020	\$40,250	\$29,249
Mortgage Payments	-\$9,095	\$0	-\$16,050	\$0
Net Cash Salary	\$31,155	\$34,020	\$24,201	\$29,249
Net Benefit		\$2,865		\$5,048

2.12 The chart below illustrates that the maximum annual benefit is dependent on the employee's annual salary.



2.13 Although there are other benefits that may be salary packaged for employees of NFPO, the overwhelming employees (80%) elect to salary package expense benefits. These expenses are

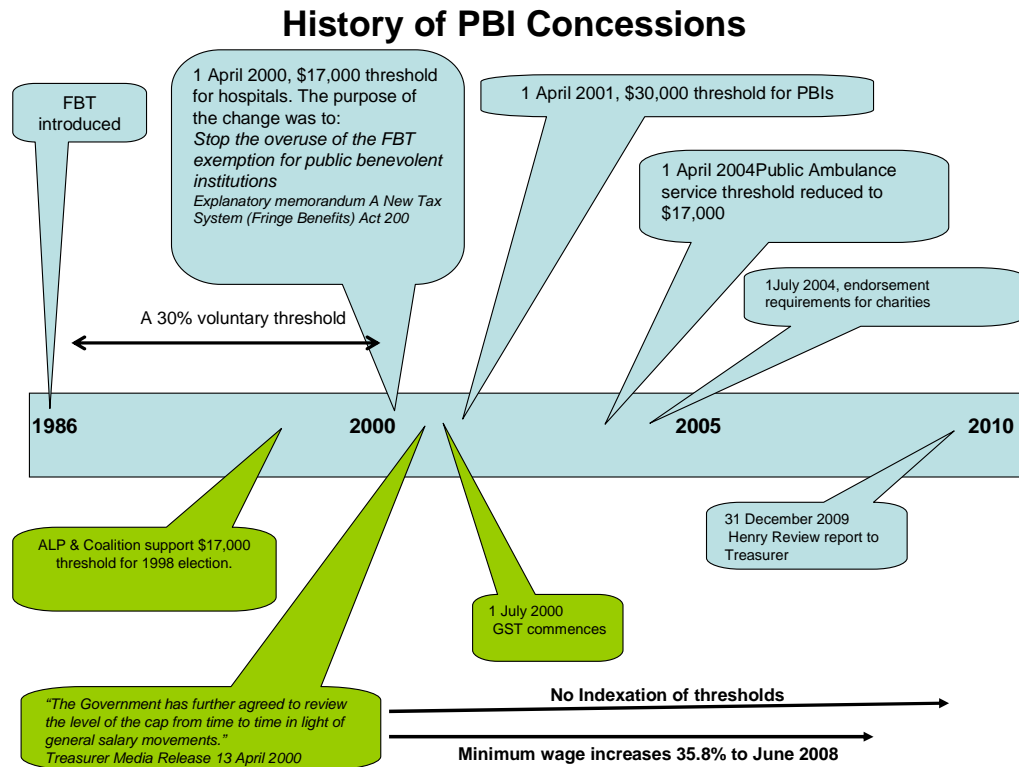
typically mortgage and rental payments, loan repayments credit card debts and every day living expenses. The types of fringe benefits salary packaged are illustrated in the chart below:



3. HISTORY AND BACKGROUND OF FBT CONCESSIONS FOR NFPO

3.1 Fringe Benefit Tax (FBT) was introduced in 1986 to enable non-cash benefits provided to employees by their employer to be taxed. The taxing of any benefits being derived from the provision of such motor vehicles to employees.

3.2 The following chart maps out the major changes to FBT for NFPO since the introduction of FBT in 1986:



3.3 From 1986 to the early 1990's salary packaging was generally only provided to executives as part of their remuneration package. Most employees did not receive access to salary packaging as part of their remuneration package.

3.4 During the early 1990's, as government funding decreased many industrial awards, agreements, collective agreements or similar were negotiated to include provisions for "flexible salary packaging". Many awards were varied and agreements made to "allow" for the first time 'award based' employees to participate in flexible salary packaging arrangements.

3.5 Prior to 2000 there was no limit on the amount that employees in NFPO could salary package and FBT was not applicable. However the responsible employers did impose self regulation and limited the amount that could be salary packaged to a maximum 30% of salary.

- 3.6 There was however a perception that the exemption was being misused and limits were imposed for NFPO.
- 3.7 The capping limits (FBT free threshold) for the Not-for-Profit Health sector and PBI sector have not changed since April 2000 and 2001 respectively.
- 3.8 The FBT capping limits were agreed to be reviewed from time to time by the government as stated by the Treasurer at the time ⁷.

“The Government has further agreed to review the level of the cap from time to time in the light of general salary movements.”

- 3.9 Since the introduction of the FBT capping limit⁸:
- The CPI has increased by 30.3 % in the period June 2000 to June 2008; and
 - the Minimum Wage has been increased by 35.8%.
- 3.10 The Senate Standing Committee on Finance and Public Administration made the following recommendation in June 2008⁹:

The committee recommends that the government consider the appropriate level of the cap on FBT-exempt benefits for NFP sector employees and whether the cap should be indexed to the CPI.

We believe that there is an exceptionally strong and compelling case to increase and index the FBT capping limit for Public Benevolent Institutions to \$40,000 per annum.

(Catholic Health Australia has argued previously for the cap on FBT to be raised in the health setting. For more information please see the Catholic Health Australia pre-budget submission at <http://www.cha.org.au/site.php?id=1749>)

- 3.11 The following table illustrates the decrease in net annual benefit that has arisen due to the lack of indexation:

⁷ Media Release 022 of 2000 – Treasurer – P Costello - Fringe Benefits Tax: Charities and Non Profit Organisations
<http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2000/022.htm&pageID=&min=phc&Year=2000&Doc Type=0>

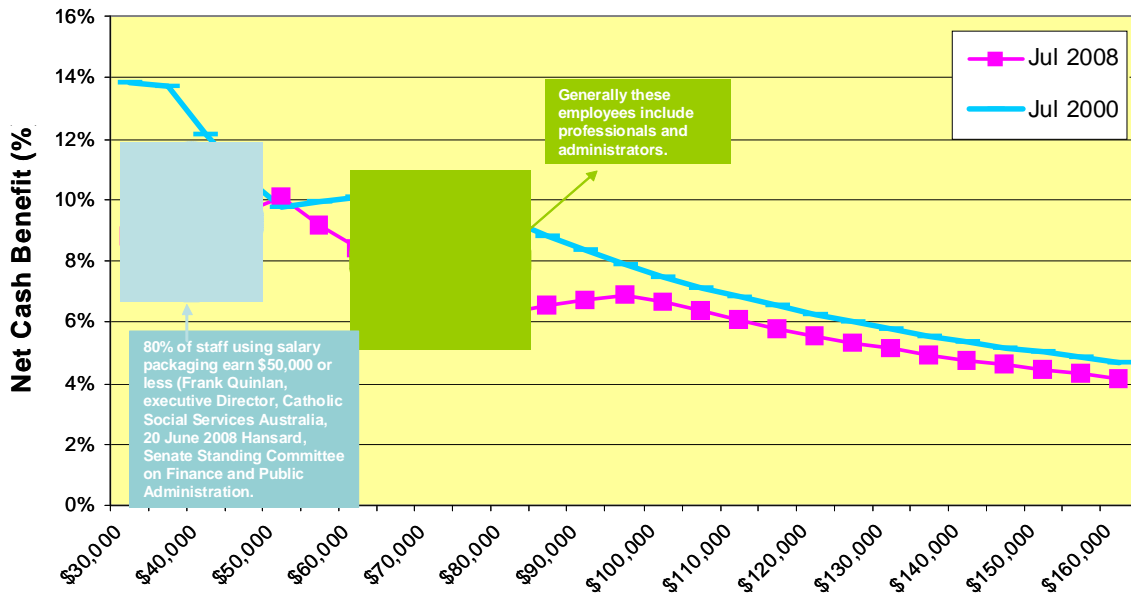
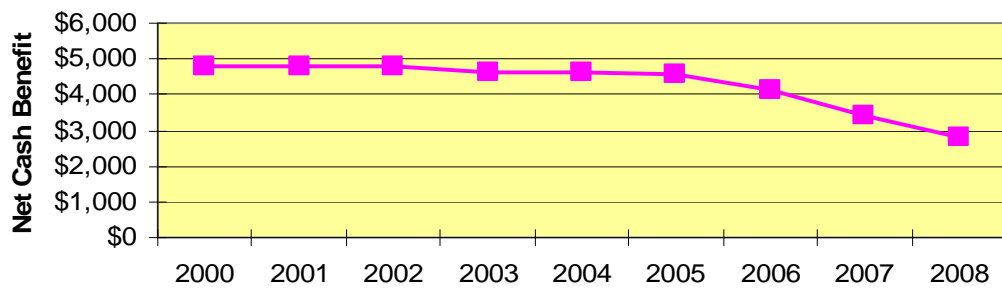
⁸ ww

⁹ Inquiry into the Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2008

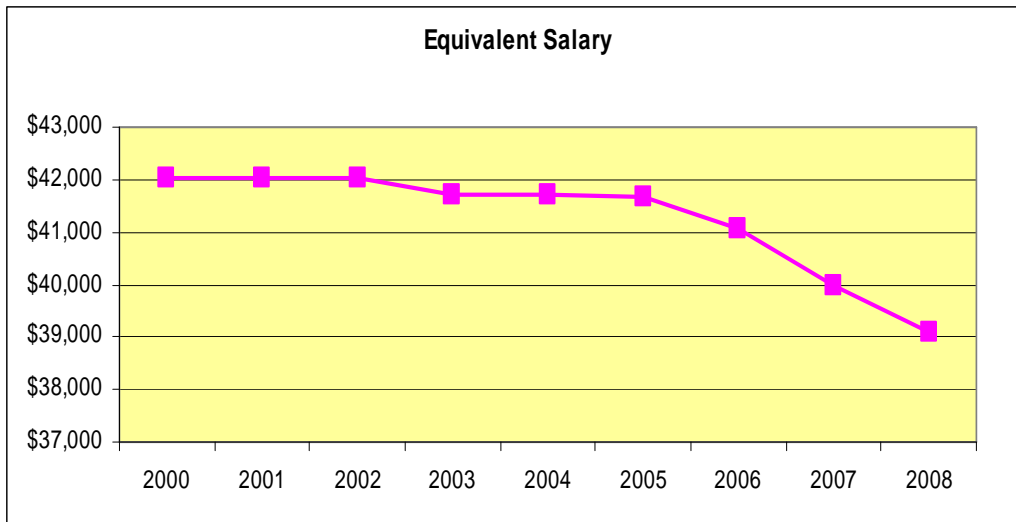
Item	Salary Packaging 2000	Salary Packaging 2001	Salary Packaging 2002	Salary Packaging 2003	Salary Packaging 2004	Salary Packaging 2005	Salary Packaging 2006	Salary Packaging 2007	Salary Packaging 2008
Salary	\$35,000	\$35,000	\$35,000	\$35,000	\$35,000	\$35,000	\$35,000	\$35,000	\$35,000
Salary Sacrifice	-\$15,450	-\$15,450	-\$15,450	-\$15,450	-\$15,450	-\$15,450	-\$16,050	-\$16,050	-\$16,050
Net Salary	\$19,550	\$19,550	\$19,550	\$19,550	\$19,550	\$19,550	\$18,950	\$18,950	\$18,950
Tax & Medicare	-\$2,597	-\$2,597	-\$2,597	-\$2,597	-\$2,597	-\$2,326	-\$2,227	-\$2,227	-\$2,227
Net Cash Salary	\$16,953	\$16,953	\$16,953	\$16,953	\$16,953	\$17,224	\$16,723	\$16,723	\$16,723
Net Annual Benefit	\$4,808	\$4,808	\$4,808	\$4,600	\$4,600	\$4,559	\$4,148	\$3,398	\$2,798
Net Annual Benefit (%)	13.7%	13.7%	13.7%	13.1%	13.1%	13.0%	11.9%	9.7%	8.0%

3.12 Since 2000 the net annual benefit for an employee with a salary of \$35,000 has decreased from 13.7% to 8.0% in 2008. That is the net annual benefit has decreased from \$4,808 per annum to \$2,798 per annum. This decrease is further illustrated in the chart below.

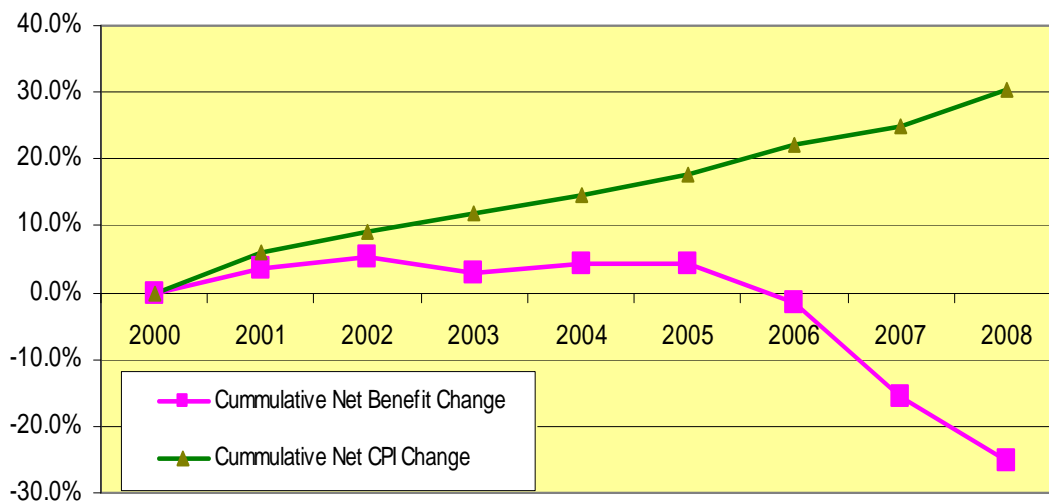
Net Annual Benefit (\$)



3.13 In 2000, this employee with a salary of \$35,000 who salary packaged the maximum amount would have through salary packaging received effectively a take-home salary of \$42,000 per annum. In 2008, a salary of \$35,000 has an equivalent value of about \$39,000.



3.14 Since 2000, the value of salary packaging has decreased by about 30% and the CPI has increased by 30%. Effectively employees in NFPO are almost 60% worse off because of the lack of indexation of the capping limits.



3.15 The NFPO sector is constantly battling to retain and attract staff. This is especially so in mission critical service delivery areas with a dependence on highly skilled staff. The constant erosion of the FBT concession (no indexation) effectively means that the value of the benefit is not as attractive as it once was. Therefore, employers are not able to “package-up” remuneration as attractively as they were able to, in order to compete favorably in the marketplace.

4. OPTIONS FOR IMPROVING REMUNERATION LEVELS TO ASSIST ATTRACTING AND RETAINING STAFF

4.1 The Government in the provision of any program or funding that improves employee remuneration would have the following objectives:

- An efficient and effective delivery system;
- Fair and equitable access to the concession;
- Low cost to employers / employees;
- Minimum cost to government; and
- Easy to understand and comply with.

4.2 The following options are available in relation to NFP organisations improving employee remuneration:

- Replace the FBT concession with the tax free threshold equivalent or support substantial salary increases to the various awards and industrial agreements for NFPO employees and increase funding accordingly for all employees in PBIs and public hospitals (**PAYG model**).
- Remove the FBT concession and increase funding to PBIs / not for profit hospitals (**NFPO**). So that awards or similar can be adjusted in terms of wage and salary levels to market rates (**GRANTS model**);
- Remove the FBT concession and provide all employees with a tax rebate equivalent to the existing concession (**REBATE model**);
- Retain the status quo (**STATUS QUO**);

4.3 The following options in relation to fringe benefits are provided in more detail:

Option	Description	Comments
PAYG Model	Replace the existing FBT concession with a rise in the tax free threshold equivalent for employees in PBIs and public hospitals or support substantial salary increases to the various awards and industrial agreements for NFPO employees and increase funding accordingly.	<ul style="list-style-type: none"> ▪ All employees will now be provided with an additional tax free threshold or an increase of salary of either \$9,095 or (public health) \$16,050 (PBI). Substantial initial and ongoing cost to government. ▪ Employers will have the burden of updating their payroll and administration systems long, lead times will be required. ▪ Cost to government will greatly increase because now all employees will receive the concession or salary increases. This will be an ongoing cost to government and will require indexing or adjustment for wage increases. ▪ There may be complex industrial relations issues. E.g. casuals would receive the same increase as full time employees – generally not practical or cost effective. ▪ May cause wages pressure in other sectors. (Police, Education) private sector, private sector health. ▪ <u>NOT RECOMMENDED.</u>
Grants Model	Replace the FBT concessions for PBIs and hospitals and increase their funding equivalent to the FBT concession in the form of yearly indexed grants so that employers can pay increased wages and salary to ALL employees.	<ul style="list-style-type: none"> ▪ The funding for PBIs and public hospitals will be increased and the employers will be required to pass on the additional funding to all employees as salary increases equivalent to the current FBT concessions for each employee. ▪ May cause wages pressure in other sectors. (Police, Education) private sector, for profit private health. ▪ Increased costs to employers e.g. additional superannuation and other on costs. ▪ Employers are very skeptical of grants and generally don't favor grants as a reliable and efficient delivery mechanism. ▪ Clearly an increase in funds (or a grant) from all sources could not be negotiated or achieved. (eg: Local government, trusts and foundations, charitable donors, etc)

		<ul style="list-style-type: none"> ▪ The cost to administer grants is expensive. ▪ Substantial increase in cost to Federal Government. ▪ Substantial increase in costs to State Governments and all others funders (local government, trusts and foundations, charitable donors, etc) ▪ <u>NOT RECOMMENDED.</u>
Rebate Model	Replace the FBT concession and provide all employees in PBIs and public hospitals with a tax rebate equivalent to the FBT concession.	<ul style="list-style-type: none"> ▪ <u>All</u> employees to receive a tax rebate equivalent to the current FBT concession. ▪ Cost to government will be significant because salary increases will need to be provided to all employees not just those who are salary packaging. ▪ Employees will not accept this model because of the delay in receiving the benefit of the rebate. (up to 12 months delay in rebate payments). If the rebate was paid quarterly there would be additional administration costs to Government in particular and for employees in the reconciliation of payments at the end of each tax year. ▪ Inefficient and confusing to say the least. ▪ <u>NOT RECOMMENDED.</u>
Status Quo	Retain the existing FBT concessions with enhancement (i.e. indexation).	<ul style="list-style-type: none"> ▪ The existing system of salary sacrifice provides an efficient low cost method (because the system already exists) for the provision of tax concessions for PBI and public hospital employees. (less than 1.5% of payments made). The existing concession is recognised by employers as an essential tool in attracting and retaining staff. ▪ The systems and programs to administer the current FBT arrangements are well entrenched and work relatively efficiently. ▪ The existing concession is important to employees in this sector. ▪ There is a growing pressure by employers and employees to index the concessions to keep up with conditions in other sectors.

4.4 We have estimated that the costs of not retaining the status quo is in excess of \$2.2 billion dollars per annum above and beyond the current cost of FBT concessions for the NFPO sector.

4.5 The Tax Expenditure Statement 2007¹⁰ provided the following estimates of the costs of the existing FBT exemptions.

	2008-09	2009-10	2010-11
	(\$m)	(\$m)	(\$m)
Capped exemption for certain public and non-profit hospitals (Exemption from FBT up to \$17,000 of the grossed-up taxable value of fringe benefits per employee) - Chapter 6, Item D6 page 142 of TES)	260	270	280
Capped exemption for public benevolent institutions (excluding public hospitals) (Exemption from FBT up to \$30,000 of the grossed-up taxable value of fringe benefits per employee) - Chapter 6, Item D8 page 142	440	460	480
Total	700	730	760

4.6 Therefore the status quo has a significantly lower cost than any of the other options. The status quo is also preferred because of its efficiency and simplicity.

4.7 McMillan Shakespeare has also costed the following in relation to the status quo:

- Indexation of the existing limits;
- Alignment of the exiting limit for public and not-for-profit hospitals with the existing PBI limit.

PBI Limit	2008-09	2009-10	2010-11
Increase in costs (\$m)	93	382	425

Public / Not-for-Profit Hospitals	2008-09	2009-10	2010-11
Increase in costs (\$m)	93	382	425

With indexation of 4% per annum from April 2010 and April 2011

¹⁰ Tax Expenditure Statement 2007 (<http://www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=1333>)

Q4.5 *Should people in different circumstances be taxed differently (for example, by age, occupation, location), and what might be the implications of such arrangements? Are tax offsets the best way to achieve differential taxation?*

We believe that the existing regime for taxing fringe benefits differently for NFPO should be maintained i.e. there should be exemptions from FBT for NFPO.

NFPO organisations should continue to access FBT exemption which enables their employees to maximize the net benefit of their salary.

We believe that all employees in NFPO should be able to be provided with the benefit of the FBT exemption by their employer through salary packaging arrangements.

The original purpose of the FBT exemption remains, taxation support for organizations that provide services to the poor, sick and needy. This is a “special sector” that rightfully has special FBT exemptions.

The issue of which organizations meet the criteria for obtaining an exemption is a separate debate and should not be used as the justification for removing the existing exemption from all NFPO.

The FBT exemption enables NFPO to maximize their funding in the provision of services. It remains the most effective method of the government supporting this sector.

The removal of the existing concessions without significant additional funding by government would impact dramatically on the services provided to the community by the NFPO.

The maintenance of the FBT exemption for NFPO is, on balance, the best option. In terms of cost to government, efficiency and simplicity.

Q4.6 *How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?*

We do not believe that the OECD practice should be adopted for NFPO.

In terms of pure efficiencies and compliance, shifting the point of taxation from 69,000 employers who currently submit FBT returns, to circa 1 million employees, does not make practical sense. Everyday working Australians need less administration and taxation

burdens not more. Additionally, from an ATO perspective collection from employers is more efficient and is likely to have a higher level of compliance. Put simply, any attempt to change the current FBT arrangements is likely to make the ATO's collection efforts more complex, expensive and less effective.

The current arrangements are relatively simply, easy to administer and are generally well understood. The NFPO sector has been very actively engaged in FBT since the early 1990's.

A model that moves the liability for FBT from the employer to the employee will add significant costs to the provision of services by NFPO. New systems will need to be developed which will create both costs and confusion.

Q7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

This submission is clearly focused on this key question. We have demonstrated and argued that the current FBT arrangements are the most efficient, cost effective and best options for NFP organisations. Largely due to the impracticality of "unscrambling the egg".

From a compliance obligation point of view, the evidence suggests that there are extremely high levels of overall compliance with the current FBT concessions and requirements.

Most employers in the sector have been offering flexible salary packaging arrangements for more than 10 to 12 years. Industrial awards or similar were all charged back in the early to mid 1990's. The sector is very well catered for with many competent outsourcing administration companies delivering low cost services to our employers.

The current FBT arrangements are well understood by both employers and employees and are very much developed. Payroll systems or similar, including administration staff understand the compliance requirements of the current FBT arrangements. A massive burden, both in terms of costs, administration and industrial relations would prevail if the current arrangements were eliminated or changed in any substantive way.

Q7.2 *Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?*

Our submission clearly sets out our key arguments and points for retaining the current FBT concessions - the status quo.

We have no confidence or trust that direct funding will be funded at the appropriate and adequate levels to adequately compensate for current benefits, particularly given the diversity of funding sources (commonwealth, state and local government, corporate philanthropy, private philanthropy and charitable donations) that contribute the wages of NFPOs, or that any immediate compensation gained would enjoy any longevity.

Short term funding cycles, changing economic circumstances and three year elections are key factors that inevitably erode the certainty of direct funding. Moreover, direct funding will conservatively cost the government an additional \$2.2 billion annually above and beyond the current cost of the FBT concessions provided for by the government.

5. RECOMMENDATIONS

5.1 We recommend the following to the Review:

- **Retain the FBT concessions for PBI and Public Hospital employers and their employees because:**
 - It is the most cost effective option for Government;
 - It is understood and valued by employers and employees;
 - It is the most practical;
 - There are systems and services already in place to administer the current FBT regime that maintain compliance and integrity;
 - It is very efficient for employees, employers and government.

- **Index the existing maximum amount from year 2000 and maintain the indexation each FBT year thereafter;**

- **Benefits should be grossed-up at the employee's marginal tax rate and not the highest marginal tax rate by Medicare levy.**

(Catholic Health Australia has argued previously for the cap on FBT to be raised in the health setting. For more information please see the Catholic Health Australia pre-budget submission at <http://www.cha.org.au/site.php?id=1749>)

6. MEETING WITH REVIEW PANEL

The Catholic Health Australia, Catholic Social Services Australia and McMillan Shakespeare would welcome the opportunity to present to some or all of the members of the Review panel to add further detail to this submission and to provide further insight on the use of salary packaging for NFPO.

7. FURTHER INFORMATION

For further information on this submission please contact either:

- Martin Lavery, Chief Executive Officer, Catholic Health Australia on (02) 6260-5980 or martinl@cha.org.au.
- Frank Quinlan, Executive Director, Catholic Social Services Australia on (02) 6285-1366 or frank.quinlan@catholicsocialservices.org.au.
- Anthony Podesta, Executive Director, McMillan Shakespeare Limited on 03 9635 0100 or anthony.podesta@mcms.com.au

8. ABOUT CATHOLIC HEALTH AUSTRALIA

21 public hospitals, 54 private hospitals and 550 aged care services are operated by the Catholic Church around Australia. Catholic Health Australia is the member body representing each of these services.

Catholic Health Australia is the largest non-government provider grouping of health, community and aged care services in Australia, nationally representing Catholic health care sponsors, systems, facilities, and related organisations and services.

The sector comprises providers of the highest quality care in the network of services ranging from acute care to community based services. These services have been developed throughout the course of Australia's development in response to community needs. The services return the benefits derived from their businesses to their services and to the community; they do not operate for profit; they are church and charitable organisations. The sector plays a significant role in rural and regional Australia, demonstrating its commitment to the delivery of services where they are needed irrespective of whether any or minimal return on investment is derived.

The Catholic health ministry is broad, encompassing many aspects of human services. Services cover aged care, disability services, family services, paediatric, children and youth services,

mental health services, palliative care, alcohol and drug services, veterans' health, primary care, acute care, non acute care, step down transitional care, rehabilitation, diagnostics, preventative public health, medical and bioethics research institutes.

Services are provided in a number of settings, for example, residential, community care, in the home, the workplace, hospitals, medical clinics, hospices, correctional facilities, as well as for people who are homeless. In addition, services are provided in rural, provincial and metropolitan settings, in private facilities as well as on behalf of the public sector.

The sector plays a significant role in Australia's overall health care industry representing around 13 percent of the market and employing around 35,000 people.

9. ABOUT CATHOLIC SOCIAL SERVICES AUSTRALIA

Catholic Social Services Australia is the Catholic Church's peak national body for social services in Australia and provides 66 member organisations provide social services to over a million Australians a year, delivering services in local communities in metropolitan, regional and remote Australia.

We work with Catholic organisations, governments, other churches and all people of good will, to develop social welfare policies, programs and other strategic responses that work towards the economic, social and spiritual well-being of the Australian community.

Catholic Social Services Australia is a commission of the Australian Catholic Bishops Conference, reporting to the Bishops through a Board of 9 persons appointed by the Conference.

10. ABOUT MCMILLAN SHAKESPEARE LIMITED

McMillan Shakespeare Limited is a public listed company on the Australian Stock Exchange (ASX Code MMS). We provide remuneration services to approximately 1,000 employers throughout Australia, including administration services for salary packaging on behalf of employers to about 200,000 employees and novated motor vehicle leasing services for about 30,000 novated motor vehicle leases.

Our clients include federal and state government departments and agencies, statutory authorities, local government, Public Benevolent Institutions, public and not-for profit hospitals, independent schools and private sector companies.



Submission on Australia's Future Tax System

NDS welcomes this opportunity to provide input into the review of Australia's Future Tax System and is pleased to expanded opportunities for those who remain disadvantaged".¹ People with disability are one of the most disadvantaged groups in Australian society.

NDS's interest in the future structure of the tax-transfer system is, simply, to maximise opportunities for people with disability to have a decent life. Achieving this requires action on two levels: the current taxation arrangements which assist disability service organisations to maximise their charitable purpose (including having the workforce necessary to provide services) need to be reaffirmed; and people with disability need to be assisted to obtain and maintain employment (and ultimately have a reasonable retirement income).

The disadvantages currently experienced by people with severe disability are extensive—alleviating them by increasing the level of the Disability Support Pension, reducing disincentives to work and strengthening the sustainability of the disability services which provide support are overdue.

General comments

Not-for-profit (NFP) organisations are an integral part of the social fabric of Australia; they connect with the lives of Australians in diverse and important ways. Most Australians will belong to, or gain support from, a NFP organisation at least once and probably at several points of their lives. NFP organisations provide services, social networks, skills development and recreation. As a whole, they help cultivate democratic habits (active participation, mutual aid, cooperation with strangers). They are at the heart of civil society.

¹ Attorney-General's Department 2008, *Architecture of Australia's tax and transfer system*, Commonwealth of Australia, Canberra, p. xii.

All NFP organisations are affected by the operation of government, although to greatly varying degrees. For some, the relationship with government extends no further than that the Government sets the regulatory framework that governs them. Community service organisations are at the other end of the spectrum. They provide essential social services but their role and impact extends much further than this.

Community services are a vital part of Australia's social and economic infrastructure and are used by most Australians at some point in their lives. Community services not only support individuals and families, but also build social cohesion, enhance equity, give voice to the needs of disadvantaged groups, mobilise voluntary effort and philanthropy and achieve systemic change. They are one of the key mechanisms by which strong, effective communities are fostered and maintained.²

Disability service providers—the organisations which NDS represents—receive government funding for the provision of various support services but invariably supplement this work with additional resources, including from voluntary effort and fund-raising. They exist to respond to the needs of some of the most disadvantaged people in our society, needs which are not provided for by for-profit organisations. And they do this in a cost-effective manner. Indeed, the provision of these essential community or social services by governments themselves would require significantly greater expenditure.

NDS considers the tax exemptions and other concessions provided to NFP organisations, charities and Deductible Gift Recipients to be appropriate and not a cost to Government revenues. Taxes are intended to be applied to private wealth. Within a disability service provision organisation, surpluses are not distributed to individuals but are re-invested in activities associated with the charitable purpose of the organisation—there is no accumulation of private wealth.

Any surpluses that may be generated by NDS members are used to support people with disability; they are ultimately expended as additional services. Suggestion that the tax concessions that assist in the generation of these surpluses should be measured in terms of 'a cost to government' is inappropriate and a misrepresentation of reality. These surpluses support the provision of services that would otherwise need to be directly funded by governments.

NDS acknowledges that while the Government may need to broaden the availability of some tax concessions to other types of NFP organisations, it is critically important that disability organisations are not disadvantaged by any proposed changes.

Currently, the provision of disability services is challenged by difficulties in recruiting and retaining staff. Relatively low pay rates for disability support workers is a key factor. Some of the tax concessions available to the sector, notably fringe benefits tax exemptions/rebates that facilitate salary packaging, mitigate these low pay rates by effectively increasing the 'take home' benefit of the remuneration. This helps lower the staff turnover rate. Unfortunately, the lack of indexation has meant that the advantage of this tax concession has been eroded over time. It is hoped that this will be addressed in this review. It is of particular concern to NDS that even greater workforce shortages in the disability sector are predicted into the future.

² The Australian Collaboration: A collaboration of national community organisations 2001, *A Just and Sustainable Australia*, ACOSS, Redfern, p. 50.

NDS would also like to see the review of the tax system respond to the persistent low employment rates of people with disability. While the general workforce participation rate has risen over the past two decades (to over 80%), the workforce participation rate of people with disability has remained static (at around 53%).³ The employment rate of people with disability similarly trails that of the general workforce. Reviewing the Disability Support Pension (DSP) taper rate and providing access to concessions and entitlements as a means of encouraging people to enter employment is warranted. Also important is ameliorating the risk of accepting employment; if employment ceases, regaining the DSP should be a simple process.

Responses to specific questions

7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

NDS reiterates that the current structure of GST concessions for NFP organisations, charities and Deductible Gift Recipients is appropriate, and assists the sector in its charitable purpose—to provide support to disadvantaged Australians. They should be retained.

Comment on a number of important tax arrangements for disability service providers follows.

- **Retain GST concessions**

All current GST concessions for NFPs, charities and Deductible Gift Recipients are appropriate and should be retained. GST concessions are applied in non-commercial areas and assist by:

- providing GST relief to disability service providers;
- providing GST relief to some people with disability and some chronic illnesses; and
- simplifying administration.

Recommendation

All current GST concessions for NFP organisations, charities and Deductible Gift Recipients should be retained.

- **Retain the tax deductibility of donations**

NDS supports the existence of tax deductibility of donations to disability service organisations with Deductible Gift Recipient status. This tax provision encourages public donations to support the work of the sector.

³ AIHW, *Australia's Welfare 2007*, pp 197-198.

Recommendations

That current arrangements for the tax deductibility of donations to organisations with Deductible Gift Recipient status be retained.

- **Retain the ability to claim imputation credits**

Investment income funds the work of many charities, to varying degrees. Imputation credits were introduced to avoid the double taxation of company profits. Later amendments improved the system by allowing charities and Deductible Gift Recipients to claim a refund of imputation credits associated with dividends. The result is a treatment of imputation credits for charities that is fair and prevents the inadvertent taxation of charities and Deductible Gift Recipients through the investments that they may hold.

It should be noted that any changes to current arrangements would also substantially alter the investment decisions of charities and Deductible Gift Recipients and prevent a proper consideration of diversified investment.

Recommendation

That charities and Deductible Gift Recipients retain the ability to claim refunds of imputation credits associated with dividends and trust distributions received by them.

- **Raise the Fringe Benefits Tax exemption/rebate cap**

NFP disability service providers across Australia are experiencing increasingly severe workforce shortages, exacerbated by wage levels which are limited by inadequate government funding. These shortages have intensified under recent tight market conditions and the inability of the sector to pay comparable wages.

Many disability service providers are endorsed as Fringe Benefits Tax (FBT) exempt employers and use the allowable fringe benefits arrangements to offer salary packaging to help attract and retain staff. The introduction, in 2001, of the FBT exemption/rebate cap (set at a grossed-up value of \$30,000 per employee in each FBT year) enabled eligible employers to effectively increase the value of employees' remuneration and assisted in the recruitment and retention of staff. Low paid workers benefit.

The value of this benefit has, however, been eroded over recent years. Since 2001, the Fringe Benefits Tax exemption/rebate cap has not been increased from \$30,000 grossed-up value per employee despite undertakings by the Treasurer at the time to review this cap regularly in light of changes in average wage levels. No increase has been made to this figure to allow for inflation, despite average weekly ordinary time earnings increasing markedly over these years.

NDS was pleased to see this important issue discussed in Federal Parliament in June 2008, with a proposal by the Australian Greens to lift the FBT exemption cap to \$40,000. While the amendment was defeated, both the Government and the Opposition indicated support for its intent. This review of the tax system provides the ideal opportunity to re-visit this issue. Unless the sector can increase the real value of the salary packages paid, workforce shortages will threaten both the viability of the sector and the quality of the services it provides.

Recommendations

That the Fringe Benefits Tax exemption/rebate cap for eligible organisations be increased in line with increases in 'average weekly ordinary time earnings' since 1 April 2001.

That indexation to annually adjust the Fringe Benefits Tax exemption cap is introduced.

- **Change the Fringe Benefits Tax liability for occasional car use**

Restricted commuter use cars are those generally stored on the premises of the employer and used during the day extensively for work related purposes by a variety of employees. Occasionally these cars are 'taken home' by an employee. This, however, is not generally a benefit to the employee but is because:

- i. it is a more efficient use of time. For example because that person's first appointment is out or near their home and it is a more efficient use of time to take the car home;
- ii. it is cost effective. For example the first appointment is closer to the employee's home than work.

To employees, the occasional use of one of the pool cars is not generally seen as a remuneration item. To employers, the calculation of this 'benefit' is administratively costly.

Recommendation

It is suggested that restricted commuter use of a car be subject to an exemption of \$2,000 in taxable value per annum. This will relieve the administrative costs associated with this minor benefit.

- **Retain the calculation of entitlement for Family Assistance benefits**

A budget measure announced in 2008 proposed changes to the approach used to calculate entitlement to Family Assistance benefits. The impact of the proposal—to move to using the gross value of reportable fringe benefits rather than the net value—would have had serious impact on the family assistance payments available to many employees of not-for-profit community service organisations. The following example demonstrates the potential impact:

If an employee of an FBT exempt employer earning \$34,000 per annum currently elects to take \$15,000 pa as an FBT exempt fringe benefit, it leaves a taxable salary of \$19,000 per annum. This arrangement provides a net salary and benefits package equivalent to that normally delivered from a gross salary of approximately \$37,000. If the gross value of reportable fringe benefits was used to calculate family assistance, this figure would be approximately \$47,000, a significant overstatement of the real value of the fringe benefit to the employee. The reduction in Family Assistance benefits that would result would be unfair, particularly on these low paid workers.

As a result of reasoned arguments, legislation was passed which prevented the introduction of this measure, which would have adversely affected the income of lower-wage employees and ultimately the capacity of disability service providers to recruit and retain staff.

NDS would like reassurance that the calculation of entitlement for Family Assistance payments—using the net value of reportable fringe benefit—will be retained for organisations that are FBT exempt. This is critically important for the low-wage workers in the disability sector.

Recommendation

That the current method of calculation of entitlement for Family Assistance payments and other Government benefits—based on the inclusion of the net value of reportable Fringe Benefit Tax—be retained.

7.2 Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

NDS supports the continuation of existing tax and funding arrangements that assist disability service organisations to further their community-based activities and makes the following comments:

- **Commercial neutrality**

NDS asserts that if a business activity of a disability service provider is incidental to the charitable purpose of that organisation it should not be taxed—that it is the purpose not the nature of the activity that should determine whether it should be taxed. This principle was affirmed by the High Court last year in the Word Investment case, where it found that the goal of making a profit was not an end in itself but was incidental to a charitable purpose.

This approach is supported by considering the impact of taxing the business activities of charities. Such a tax would result in fewer support services—the charitable purpose—being delivered and people with disability would be further disadvantaged. Governments would ultimately be called upon to address this shortfall by funding these activities.

Direct funding

NDS would be concerned by any proposals to replace tax concessions with direct funding. The current funding arrangements for the provision of disability support services—sometimes through different levels of government and numerous departments—are complex. Calculating the direct funding that was appropriate and fair may be impractical, if not impossible.

The complexity of this task would be compounded by the range and take-up of salary packaging arrangements within disability organisations and across the sector. Concern exists that direct funding calculations may overstate the prevalence of salary packaging and therefore result in lower funding being provided. This funding arrangement could ultimately put downward pressure on wages—in an already low paid sector.

Recruiting and retaining staff would become more difficult.

NDS would also be concerned that the introduction of direct funding to replace tax concessions could undermine the stability and sustainability of the sector—direct funding decisions may be applied at an administrative level and could be subject to budgetary decisions. Current arrangements (for tax concessions) are legislated, thus provide greater certainty for the sector.

Recommendation

The current structure of tax concessions provides a level of certainty for disability service providers and should be retained.

Substituting direct funding for existing tax concessions is not considered a practical or sustainable option to replace the range of tax concessions provided for NFP organisations, charities and Deductible Gift Recipients.

4.12 In a targeted system there is a trade-off between the level of income support and workforce incentives. Given this, what priority should be given to reducing the disincentives to work?

Between 1988 and 2003 (the time of the last ABS Survey of Ageing Disability and carers) the workforce participation rates of people with disability sat well below those of people without disability (about 30 percentage points lower for males and 22-25 percentage points lower for females). Participation rates for people with severe or profound disability were even lower and, of particular concern, declined between 1998 and 2003. For women with severe or profound disability, this decline occurred during a period of significant increase in the general female workforce participation rate.⁴

⁴ AIHW, Disability in Australia: trends in prevalence, education, employment and community living, Bulletin 61, 2008, p. 22.

The employment rate of people with disability similarly trails that of the general workforce; their vocational education and training (VET) participation rate is low and career pathways are lacking.

This bleak employment picture contributes to the growing income gap between households containing a person with disability and other Australian households.⁵

Only one in ten Australians in receipt of the Disability Support Pension (DSP) has any income from paid employment, a low proportion by OECD standards. Australia experiences the same paradox as other OECD countries: although people's overall average health status is improving, more people are leaving the workforce and relying on health-related income support.⁶

NDS believes that a number of changes are needed to provide greater incentives for people with disability to take on the risks associated with employment.

- **Access to the Disability Support Pension**

A major barrier to employment for people with disability is the loss of security of being able to receive the DSP if their employment ceases. NDS supports an OECD recommendation that people with disability who cease to be employed should be able to easily move back onto the DSP (relaxing further the current benefit suspension rules of two years).⁷ This would provide a 'safety net' which would mitigate fears about future financial security.

Related to this issue are the taper rates for DSP and access to a range of concessions and entitlements. Under current arrangements, a single person on the DSP loses 40 per cent of the income they earn over \$138 per fortnight. This taper rate, when considered with the often higher living costs experienced by people with disability and reduced access to concessions (see 'Responding to other costs of disability' below) can make employment a financially unattractive option

Recommendations

That the benefit suspension rules (currently two years) are relaxed for people with disability who enter the workforce.

That the taper rates for the Disability Support Pension are lowered.

- **Improving the mobility allowance**

The Mobility Allowance is important in the lives of many people with disability in employment or training who, because of a disability or medical condition, cannot use public transport without assistance. The higher rate is payable to people who are in receipt of Disability Support Pension, Newstart Allowance or Youth Allowance and are working (or looking for work) of 15 hours or more a week at the minimum wage or above. All others receive a lower rate.

⁵ OECD, *Sickness Disability and Work: Breaking the Barriers*, volume 2, 2007, page 12

⁶ OECD, *Ibid*, page 11.

⁷ OECD, *Ibid*, p. 23.

The Australian Government created a higher rate of Mobility Allowance as part of its welfare-to-work package, announced in 2005. Initially it proposed restricting the higher rate to people who would no longer be eligible for Disability Support Pension under new stricter rules. The higher rate would help compensate or assist people who, under the new rules, would receive a lower rate of income support (Newstart or Youth Allowance) and be required to work or look for work of 15 hours or more.

However, the Government was persuaded to relax its original position by extending the higher rate of Mobility Allowance to people in receipt of Disability Support Pension, as long as they were either working or looking for work in the open labour market of 15 hours or more. This extension of the higher rate to a group unaffected by the welfare-to-work changes weakened the rationale for maintaining two rates of Mobility Allowance.

NDS believes that maintaining a two-tier Mobility Allowance is inequitable and unjustifiable. The inequity is particularly apparent once it is recognised that the lower rate applies to people who are most likely to be in need of assistance—those with a disability so severe that it prevents them from working 15 hours per week and all people with disability employed in an Australian Disability Enterprise.

Australian Disability Enterprises employ people with a disability (approximately 19,000) who find it difficult to work or maintain employment in the open labour market. Ninety-seven per cent of these supported employees receive the Disability Support Pension and most are paid a productivity-based wage. On average, supported employees in Disability Enterprise receive a significantly lower wage than employees with disability in the open workforce and their capacity to pay for transport to work is less. Australian Disability Enterprises report that some supported employees have to spend over \$1000 a year more than their current Mobility Allowance in order to get to work.

Under current arrangements, therefore, the lower the employee's income and the more severe the disability the less likely he or she is to receive the higher rate of Mobility Allowance.

There is no sound justification for continuing to deny access to the higher rate of Mobility Allowance to people who are most likely to be in need of it.

Recommendations

That the Government remove the lower level of Mobility Allowance and pay all eligible people with disability at the higher rate.

That the Government annually reviews and adjusts the rate of the Mobility Allowance.

- **Responding to other costs of disability**

To encourage people with disability to take up employment opportunities, consideration should be given to allowing them retain some access to concessions and entitlements for a period of time beyond current limitations. These concessions, available to holders of a Pension Concession Card or a Health Care Card, are important contributors to the quality of life of people with disability and some chronic illnesses and include:

- travel concessions;
- housing and rental assistance;
- concessions on rates and other local and state payments;
- reduced rates for telephone and other utilities, including energy payments;
- mortgage relief; and
- pensioner discounts on social participation opportunities.⁸

This issue is particularly important in light of the fact that many people with disability have higher costs of living (such as the costs of medication, aids and equipment, support services and transport) purely as a result of their disability. Research by the Social Policy Research Centre in 2006 attempted to improve the understanding of the link between the presence of disability and poverty by using data from the 1998–99 Household Expenditure Survey. It found:

...the costs of disability represent a substantial percentage of disposable income, and thus poverty rates are much higher where there is a disability present. Estimates based on the impact of the severity of the restriction associated with the disability are also derived and make a similarly large difference to conventional poverty estimates...The size of the impact of disability on the risk of poverty and actual hardship suggests that action is required to ensure that people with disability no longer have to confront a greatly increased risk of poverty in addition to many other challenges.⁹

This research confirmed the knowledge of many that disability frequently increases the costs of living.¹⁰ Indeed, the Senate Community Affairs References Committee in the report into the *Inquiry into Poverty and Financial Hardship* noted that disability was a close companion of poverty, resulting from a combination of two factors: the increased cost of living and the reduced incomes of those with disability.

People with disability are not, however, a homogenous group and any costs they incur as a result of disability will vary markedly. The type and severity of disability, and possibly whether they are in employment, are factors which will affect the level of additional costs incurred. Some disabilities will not impose additional costs on an individual; some will impose moderate additional costs; and some will impose very substantial additional costs. A means of factoring this differential cost into the financial support provided to many people with disability is warranted.

⁸ Human Rights and Equal Opportunity Commission 2005, *Workability: People with disability in the open workplace, Interim Report of the National Inquiry into employment and disability*, HREOC, Canberra.

⁹ Saunders, Peter 2006, *The costs of disability and the incidence of poverty*, Social Policy Research Centre, Sydney, abstract.

¹⁰ See attached list, Selected References: Cost of disability

Further research is required to adequately understand this issue and to respond to it with an appropriately structured allowance.

Job seekers with disability also often face barriers to employment which extend beyond the workplace: a lack of in-home support to prepare for work each day or a lack of accessible transport, for example. Although the responsibility for non-employment support services lies principally with State and Territory governments, their availability affects employment. Taxation concessions for disability service organisations providing this support ultimately assist people with disability find and maintain employment.

Recommendations

That the concessions available to holders of the Pension Concession Card and Health Care Card be retained.

That greater access be allowed to concessions and entitlements for people with disability and some chronic illnesses who enter the workforce.

That the Government acknowledge the additional costs often associated with disability by commissioning research to understand its differential impacts and implementing an allowance (possibly with varying levels) as soon as is practicable. Consideration of the additional non-discretionary costs of workforce participation should be included.

5.2 As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?

Many people with disability are not accumulating superannuation savings, or if they are, may be accumulating very little. On retirement they will be reliant on an aged pension to fund their living expenses.

When the Superannuation Guarantee system matures, the Australian Government must ensure that people currently excluded from it are not further marginalised or disadvantaged. The rate of an aged pension must provide for a reasonable and decent life.

Recommendation

That the rate of an aged pension continues to be regularly adjusted to a level that is adequate to provide a decent life for those who have not been able to fund their own retirement.

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About National Disability Services

National Disability Services is the peak industry body for non-government disability services. Its purpose is to promote and advance services for people with disability. Its Australia-wide membership includes more than 650 not-for-profit organisations, which support people with all forms of disability. Its members collectively provide the full range of disability services—from accommodation support, respite and therapy to community access and employment. NDS provides information and networking opportunities to its members and policy advice to State, Territory and Federal governments.



Submission to the Review of Australia's Future Tax System

April 2009

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Introduction

The Future Tax System Review offers Australia an opportunity to ensure that its taxation laws are easy to understand, are sufficiently comprehensive to protect government revenue and, most importantly, are effective to promote current social and policy initiatives.

The purpose of this submission is to highlight several of the proposals submitted in the first consultation round and to outline why the Review should prioritise these proposals for implementation into Australian law. These submissions address the application of fringe benefits tax (“FBT”) to certain benefits, as well as proposing several changes to FBT law that have the potential to create significant benefits for the country.

The applicant, SmartSalary, is one of Australia’s largest providers of salary packaging services and administers approximately 80,000 salary packages. As such the applicant is able to outline impact of changes to FBT law from the perspective of ordinary working Australians – **it should be noted in this regard that over 90% of our client base are employees of either government, hospital or not-for-profit employers.**

It is anticipated that the diversity and market position of the Australian organisations that have already submitted the proposals summarised in this paper will effectively highlight the breadth of support throughout Australian industry for the proposals summarised below.

Summary

This submission to the Future Tax System Review (“the Review”) makes the following points:

Part 1: The FBT car concession

1. Retention of an FBT concession for cars is consistent with Australia’s current **economic priorities**;
2. Retention of the FBT concession for cars is necessary in order to facilitate **business efficiency**;
3. Retention of the FBT concession for cars is necessary to **preserve Australian worker entitlements**, and
4. Retention of an FBT concession for cars is consistent with Australia’s current **environmental priorities**.

Part 2: FBT concessions for alternative transport

5. **FBT concessions for Bicycles** should be considered in order to promote environmental and public health initiatives; and
6. **FBT concessions for Public Transport** should be considered in order to promote environmental and public health initiatives.

Part 3: Maintaining taxation law fairness and simplicity

7. The FBT concessions for not-for-profit philanthropic and community-based organisations should be retained in their current form in order to **preserve current efficiencies**; and
8. The FBT concessions for not-for-profit philanthropic and community-based organisations should be indexed to the CPI in order to preserve its value.

Further detail in relation to each of the positions noted above is contained in the remainder of this submission.

FBT concessions: a valuable tool for Australia

The FBT treatment of specific fringe benefits is an effective tool that enhances Australia's ability to successfully implement and execute policy initiatives. There is historical evidence demonstrating that taxation law can be effective in influencing social and economic activity in ways that are of significant benefit to the communities and economies in which they are enacted.

Recent examples of taxation law being used to successfully execute social policy include:

- Amendments to the taxation of employee superannuation contributions: increased taxpayer superannuation balances
- The 2008 increase in the Child Care Tax Rebate: increased worker participation through cheaper access to child care, and
- The various State and Federal first homeowner grants: increased Australian home ownership.

The Applicants recommend that the Review consider the amendments and adjustments to Australian FBT law that have been set out below in order to increase the successful delivery of **environmental, economic** and **social** benefits.

Part 1: The FBT car concession

The first part of this submission addresses the ongoing application of the Statutory Formula Method (referred to in the remainder of this submission as “the FBT car concession”) for calculating the taxable value of a car fringe benefit for FBT purposes. This document:

- summarises the positions advocated in relation to this issue during the Review’s first round
- provides an update (where available) on the current position adopted by those applicants, and
- **identifies the clear underlying theme shared by the vast majority of those making submissions in relation to this issue.**

In addition, this document also outlines the Applicant’s view on the overall impact of the options already proposed and recommends the best way forward in this regard.

1. Economic benefits

Since it was first introduced, the FBT car concession has acted as an effective consumer subsidy supporting sales for all participants within the Australian motor vehicle and related industries. Using the concession Australian employers have been able to purchase fleet vehicles without overwhelming tax and compliance costs; and Australian employees have been able to obtain modest tax savings through novated leases and salary packaging arrangements.

In fact, at the time FBT was initially introduced into Australia, the Labor Government carefully considered the potential for unintended deleterious effects on the Australian economy. It was generally accepted that a ‘non-concessional’ approach to vehicle taxation would significantly harm the Australian vehicle industry, and in that regard the concessional nature of the statutory formula was specifically identified by the Federal Treasurer, the Hon. Mr Paul Keating, as one of the key factors that would operate to protect the Australian car industry:

“It is the Government's considered view that the new tax rules are quite fair - indeed the arbitrary formula is somewhat generous - and will not produce distortions in the car market.


That is not to say that the costs of Fringe Benefits Tax will have no impact on car sales. We judge, however, that loss of unit sales due to the tax will fall within tolerable limits for the industry and certainly will not impact in a discriminatory manner.”

Clearly implied from the Hon. Mr Paul Keating’s comments above is that without the ‘arbitrary formula’ (i.e. the FBT car concession) the application of FBT to car benefits could easily lead to a drop in car sales that would be intolerable to the Australian industry. We submit that the same holds true today, i.e. that abandoning the FBT car concession would result in an intolerable decrease in vehicle sales.

In support of this we note the following comment made by Toyota Financial Services in their submission to the first consultation round:

“Toyota Finance considers that any material adverse changes to [the] statutory formula method will result in a material demand decrease for new vehicles and material losses in after-tax disposable incomes for families and individuals who employ salary package vehicles.”

This position is shared by all major vehicle industry participants that made a submission in the first round, or that intends to make a submission in the second round:

First Round Submission Applicant	Proposed action re FBT car concession
Toyota Finance Australia	No amendment to the Statutory Fraction Method is required and/or desirable. If the Review is compelled to make a change the Australian Finance Conference proposal (summarised below) is the most reasonable.
GM Holden	Given the significant proportion of domestically produced vehicle sales to fleet customers (75 per cent in 2007), it is vital that the importance of these sales to the sustainability of the local industry is borne in mind in any consideration of changes to the current FBT arrangements for vehicles.
 Federal Chamber of Automotive Industries	No amendment to the Statutory Fraction Method is required and/or desirable.

Motor vehicle manufacturers, importers and retailers are of course not the only industries who will potentially be impacted by abolition of the FBT car concession - many other Australian industries and employers have also benefited from the increase in vehicle demand that flows from this valuation method. Examples in this regard include:

- Fleet and Novated financiers
- Vehicle and related insurers
- Salary Packaging administrators, and
- Vehicle maintenance and repair.

Given the significant economic hurdles that the Australian vehicle (and related) industries continue to face, particularly in light of the present global financial crisis, the need for continued industry assistance through this and other policy initiatives remains high. This does not necessarily mean that the car concession should remain unchanged - there are strong arguments for altering its operation to support environmental initiatives (as noted below) - but it strongly suggests that the concession should be retained in some form.

In support of this proposition the Applicants note in particular that:

- According to the Federal Chamber of Automotive Industries (“the FCAI”) it is anticipated that the 2009 calendar year will see a 13% decrease in vehicle sales throughout Australia,
- A number of manufacturers, notably Toyota and GM Holden, have recently announced plans to build hybrid and other fuel efficient technology vehicles in their Australian operations, **and**

- The Australian Government has noted an intention to deliver the \$6.2 billion *New Car Plan for a Greener Future* to both support employment within the Australian car industry and promote green vehicle construction and use within Australia.

Given the above it is quite clearly in Australia's economic interests to continue to offer the FBT car concession in some form, especially if the concession is modified to encourage taxpayers to purchase and use environmentally friendly vehicles. It is quite evidently counter-productive to strip \$1.3 billion in demand out of the Australian vehicle industry at the same time the Government is seeking to support the vehicle industry through a \$6.2 billion incentive.

Key Message: it is in Australia's fundamental interests to retain an FBT car concession in order to promote economic activity within the motor vehicle and related industry sectors. This is particularly so given current global economic conditions as well as recent moves by on-shore manufacturers to produce low-emission vehicles.

2. **The FBT car concession: necessary for business efficiency**

The statutory formula method for calculating FBT on a car fringe benefit is concessional not only in that it offers moderate tax savings; it also simplifies the calculation of tax for FBT reporting purposes. Without the simplified methodology offered by the statutory formula method all employees in receipt of an employer-provided vehicle would have to value their cars annually using the operating cost method. Specifically, this would require that:

- All employees track the use of their vehicles by periodically completing a 12-week log-book - the details of which are then used to calculate a 'business percentage' for FBT calculation purposes, and
- All employers track all purchase and running cost expenditure relating to each individual vehicle, including notional depreciation and interest amounts, for FBT calculation purposes.



As such, any move to abolish the current FBT car concession without replacing it with a similarly simplified alternative would represent a significant compliance burden for employers and employees alike. This would run counter to the Review's stated goal of reducing Australian tax complexity.

This fact is reflected in comments made by the Minister assisting the Treasurer, the Hon. A.C. Holding, M.P in his second reading speech to the Taxation Laws Amendment (Fringe Benefits and Substantiation) Act 1987:

The measures contained in the Bill reflect a response by the Government to community concerns that the car log book and certain other record keeping obligations contained in the original legislation were overly burdensome.

A better alternative to the abolition of the FBT car concession entirely is to *change* the concession for cars in a way that supports increased environmental outcomes without significantly increasing the complexity of the concession for employers or employees. Under this alternative the simplicity of the FBT car concession is retained – including all the inherent compliance savings associated with the current concession.

Some useful examples of potential amendments to the FBT car concession that would retain its current simplicity are included in the following suggestions made in the first consultation round:

First Round Submission Applicant	Proposed action re FBT car concession
GM Holden	Simplify to 2 statutory 'brackets' with lower tier for vehicles using alternate fuel technology
 Australian Conservation Foundation	Calculate FBT based on vehicle emissions rather than kilometres travelled
PriceWaterhouseCoopers	
 Australian Finance Conference	Retain Statutory Formula Method to ensure ease of compliance but increase the current 4 statutory brackets to 15 in order to 'smooth out' kilometre travel

This submission recommends that the Review adopt one of the above *amendments* that have been proposed to the FBT car concession, or a variation thereof, in order to protect the simplicity currently provided by the statutory formula method.

Key Message: removal of the Statutory Formula concession for valuing car fringe benefits (as opposed to amending it as proposed in this submission) would result in unacceptable complexity for Australian businesses. It is vital that some form of concession be retained in order to avoid complex 'Operating Cost Method' calculations for all employer-provided vehicles.

2.1 Transition rules

It is important to note that if the Review decides to recommend any variation of the FBT car concession it will be critical to Australian business that transition rules are also recommended in order to protect vehicle benefits already in place. Transition rules will be necessary to avoid excessive compliance costs for businesses, as well as financially damaging outcomes for individual taxpayers and employers who have entered into salary packaging arrangements under the current rules.

In this regard transition rules should be implemented in order to ensure the following two outcomes for Australian taxpayers:

- Australian employers and businesses should be given sufficient time to revise internal software (and other benefit administration tools) in order to prepare for the introduction of new fringe benefit calculation rules, and
- Employers/employees who have already entered into FBT/salary packaging arrangements at the time of any rule change should not be penalised as a result of a new calculation methodology.

This submission therefore advocates that, in the event that any of the changes proposed above are adopted by the Review, both a **transition period** and **grandfathering rules for existing arrangements** be included in any rule change.

3. **The FBT vehicle concession is necessary to preserve Australian worker entitlements**

The use of the FBT vehicle concession to **deliver remuneration benefits to Australian workers** through novated leases has not been widely discussed in the first round of submissions to this Review. Nonetheless use of the FBT car concession in this way represents a fundamental part of the remuneration of a very significant number of Australian working families.

In fact, of the salary packaging customers managed by the Applicant in this submission **86% of salary packaged vehicles relate to Federal or State government departments.**

Far from being a tool for the wealthy, salary packaging is used primarily by lower paid workers and is a means to maximise the value of their remuneration.

In many cases salary packaging a vehicle using the FBT concession for cars is a way of adding several thousand dollars to a worker's disposable income whilst simultaneously helping them to afford one of their family's single most important assets. Removal of this benefit would significantly impact these families – in fact **the lower the family income, the greater the impact of any removal of the car concession will be.**

Far from being a remuneration tool for the wealthy, salary packaging is relied on most heavily by Australian workers at the lower end of the remuneration range. Any remuneration technique that delivers a \$2,000 increase in disposable income is extremely valuable to a family earning \$50,000 or less, but far less so to a relatively wealthy family.

Key Message: removal of the Statutory Formula concession for valuing car fringe benefits (as opposed to amending it as proposed in this submission) will result in the loss of a remuneration benefit that many Australian families depend on. Far from being Australia's wealthiest, or even wealthy, families – **those most affected will be those at the lower end of the remuneration spectrum.**





4. **Environmental benefits**

The first round of submissions to the Review included a number of recommendations arguing that the FBT car concession in its current form provides an incentive for Australian car owners to engage in additional driving in order to obtain the maximum tax savings. This proposition appears to have been broadly accepted by the Review, as indicated by the following comments in the December 08 Consultation Paper:

Around a third of submissions expressing concern about the environment discuss the fringe benefits tax arrangements for motor vehicles. Most oppose a tax system that encourages people to drive more and contribute to noise and air pollution, greenhouse gas emissions and urban traffic congestion.

The common position taken by these submissions was therefore support for amendment of the FBT car concession in order to better enable Australia's greenhouse reduction targets.

Some of the key positions taken in the first round of submissions are summarised in the following table:

First Round Submission Applicant	Proposed amendment to FBT car concession
 <p>Australian Finance Conference</p>	Retain Statutory Formula Method to ensure ease of compliance but increase the current 4 statutory brackets to 15 in order to ‘smooth out’ kilometre travel
 <p>Australasian Fleet Managers Association</p>	Set the FBT statutory rate at a flat rate in the range of 11% to 16%
 <p>Australian Conservation Foundation</p>	Calculate FBT based on vehicle emissions rather than kilometres travelled
<p>PriceWaterhouseCoopers</p>	
<p>GM Holden</p>	Adopt a two tier statutory fraction system with lower tier for vehicles using alternate fuel technology or adopt Australian Finance Conference position (above)
 <p>GreenPeace</p>	Amend FBT car concession to eliminate incentive for additional vehicle travel

While the precise nature of any amendment to the FBT car concession should be left to the Review to determine, this submission strongly advocates that abolition of the FBT car concession should not be considered.

As noted earlier in this submission – FBT policy is an effective and therefore valuable tool that allows the Australian Government to influence Australian worker behaviour. To simply discard this valuation methodology in its entirety, i.e. to remove the FBT car concession, would be to squander an effective and important tool for delivering environmental change. From an environmental perspective, it is fundamentally in Australia’s best interests for the FBT car concession to remain as a tool to influence Australian driver behaviour.

Key Message: it is in Australia’s fundamental interests to retain an FBT car concession in order to encourage Australian drivers and employers to make vehicle purchase and use decisions that are not harmful to the Australian environment.

Whilst there are other alternatives available to influence driver behaviour, such as direct rebates and/or income tax concessions, maintaining the concession within the FBT law has the benefit of:

- influencing both personal vehicle purchasing decisions *and* business fleet purchasing decisions on a long-term basis, and
- influencing not only the decision of *what* vehicle to purchase, but *how* that vehicle is used on a yearly basis.

Part 2. FBT concessions for alternative transport

In the same way that the FBT car concession has the potential to drive Australian taxpayer behaviour, other FBT concessions can be used similarly to drive behaviour in a way that satisfies Government policy goals.



This submission contends that the following FBT concessions have significant potential to further promote the Government's current emissions reduction initiatives:

- **FBT concession for public transport:** a capped valuation concession, e.g. a 25% discount, for employer reimbursement of costs incurred in using public transport to travel to and from work, and
- **FBT concession for bicycle purchase costs:** a valuation concession or exemption for employer assistance to employees in relation to the purchase of a bicycle.

Both of the above changes were suggested in the initial round of submissions to the Review and could deliver significant environmental benefits.

5. FBT concession for public transport

A number of first-round submissions to the Review argue in favour of an FBT exemption or concession for public transport, including:

First Round Submission Applicant	Proposed amendment to FBT car concession
 Australian Conservation Foundation	“... extending FBT exemptions to salary packaged public transport and active transport options”
 Tourism & Transport Forum Australia	“An equal FBT exemption to salary-packaged cars for public transport users.”

The above submissions highlighted the potential environmental benefits of using Australia's FBT laws to encourage workers to use public transport to attend their place of employment in preference to a private vehicle. The submissions also note additional benefits such as congestion reduction in Australia's large cities.

Similar to the FBT concession for bicycle purchase costs discussed below, an FBT concession for public transport would be effective in influencing taxpayer behaviour – especially employee taxpayers.

The cost to Federal Government revenue from implementing this concession can be effectively managed through the use of built-in cost limiters. This submission recommends that the Review consider the following in this regard:




- limiting the FBT concession to a valuation discount (e.g. value at 75% of cost) rather than a complete exemption; and/or
- capping the value of the FBT concession to a specified amount per employee.

Given that employee travel to and from work comprises such a large component of Australian vehicle use and congestion an FBT concession for public transport costs has the potential to

deliver significant change to vehicle use patterns. Implementation of an FBT concession for public transport costs should therefore be strongly considered in order to better pursue policy objectives aimed at decreasing vehicle congestion.

6. FBT concession for bicycle purchase costs

A number of first-round submissions to the Review also argue in favour of an FBT exemption for bicycles. This submission notes that this is another area in which the Government can better utilise FBT as a policy tool, i.e. by formulating a concession for employee use of bicycles.

First Round Submission Applicant	Proposed amendment to FBT car concession
 Australian Conservation Foundation	“Recommendation 5.4: Exempt public transport and active transport benefits from fringe benefits tax.”
 The Cycling Promotion Fund	“We note and endorse the policy initiatives adopted in other countries to promote bicycle use and other forms of sustainable and active transportation, recognising both the severity of transport problems and the powerful incentive that taxes can have on behaviour.”
 The Australian Bicycle Council	“Consideration should be given to the removal of FBT where cycling is promoted by employers as a means of encouraging more widespread application of sustainable transport options.”

The potential benefits of an FBT concession for bicycle purchase costs are highlighted by a similar scheme has already been successfully introduced in the United Kingdom. This scheme has lead to a range of benefits which derive from an increase in the use of bicycles by employees for home to work transport.

UK bicycle subsidy scheme:

Employers in the UK are able to assist their employees to obtain bicycles that are suitable for travel to and from work through a scheme that, in effect, amounts to an FBT concession.

Under the UK’s Cycle to Work initiative employers can purchase bicycles and provide them for employee use, while allowing the employees to repay the purchase price over three years using pre-tax income.

The scheme is limited in a number of significant ways however, in order to better tailor its outcomes to the specific environmental policy being prosecuted by the UK government, e.g.:

- The employee must use the bicycle more than 50% of the time for journeys between home and their workplace;
- The scheme must not be limited to specific employees – i.e. it must be freely available to all employees and not offered to specific groups on more favourable terms, and
- Ownership cannot be transferred to the employee during the repayment period.

The scheme is seen as providing both environmental and general workforce health benefits, both of which are current policy priorities for the UK government.

Once again, the UK Cycle to Work Scheme **demonstrates the potency of FBT concessions as a means of pursuing government policy**. Rather than abandoning FBT as a policy implementation tool, the UK have actively embraced it and in the process delivered significant community health and environmental benefits. At the same time UK businesses have been given a valuable tool for relieving wage pressure through the use of tax-effective remuneration options.

This submission recommends that the Review consider implementation of a similar 'Cycle to Work' scheme in Australia through creation of a targeted FBT concession.

Part 3. FBT concessions for the Not-For-Profit Sector

A key goal of the Future Tax System Review is the reduction in complexity of Australia’s taxation laws. It was a common theme of many first round submissions to note that Australia’s FBT laws are unnecessarily complex given the relatively small proportion of Australia’s overall tax take that they represent.

With that in mind this submission notes that all FBT concessions apply valuation and/or exemption rules that involve some level of complexity. While this complexity can be an impediment to the introduction of new FBT concessions, or indeed the retention of current FBT concessions, it is important to note that this will not always be the case.


One significant example of a FBT law that is not overly complex is the FBT concessions for the not-for-profit industry (“the NFP industry”)

7. Preserving tax law simplicity: the NFP industry incentives

The following ‘Consultation Question’ has been specifically asked in relation to the current review:

Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

This submission notes that legislative complexity *does not* act as a significant impediment to delivery of the FBT concessions for Public Benevolent Institutions and some Public Hospitals. This is reflected in the following submission from the St Vincent de Paul Society:

First Round Submission Applicant	Proposed amendment to FBT car concession
 <p>The St Vincent de Paul Society</p>	<p>“There are few problems with the current tax system’s treatment of charities. In fact, the Society has always considered favourably the ATO’s administration of the present taxation Acts and Regulations as the affect Charitable Institutions and Public Benevolent Institutions.”</p>

In addition to the support of Australian charities, such as above, the Applicants note that Australian industry and technology has also stepped in to assist smaller organisations address the issue of FBT law complexity. Specifically, the Australian salary packaging industry has been helpful in delivering these concessions to small to medium charities simply and effectively.

The salary packaging industry facilitates the delivery of benefits associated with Australia’s various FBT concessions and in particular vehicle and charity/hospital concessions. To the extent that taxation law complexity is necessary in order to achieve specific policy outcomes (for example in order to protect revenue) the salary packaging industry operates to mitigate the impact of that complexity through expert advice and innovative technology.

That is, the salary packaging industry makes taxpayer use of FBT concessions easy – even where those concessions contain elements of legislative complexity. In fact, this very point

was made by Mr Ken Henry in the Architecture of Australia's tax and transfer system paper released in August 2008:

Technological changes mean that it is now much easier for employers and employees to utilise salary sacrifice arrangements. Several companies specialise in providing these arrangements, further enhancing their accessibility.

As such this submission's response to the Consultation Question noted above is that removal of the FBT concessions for philanthropic and community-based organisations would not lead to an increase in the efficiency with which these concessions are passed on to taxpayers. In fact, alternative tax concessions, particularly moving the concessions from FBT to Income Tax, has the potential to significantly complicate delivery of the tax savings especially if the changes are such that the salary packaging industry can no longer facilitate delivery of the benefits.


Key Message: removal of the FBT concessions for philanthropic and community-based organisations would not lead to an increase in the efficiency with which these concessions are passed on to taxpayers. The Australian salary packaging industry already facilitates easy access to the present concessions.

8. Preserving the value of the FBT concessions for the NFP industry

The current FBT concessions for the NFP industry apply a 'tax-free threshold' to all fringe benefits provided to eligible employees. Those thresholds have been set at specified amounts, depending on the NFP industry within which the employee works:

- a \$17,000 grossed-up taxable value threshold for not-for profit hospital employees, and
- a \$30,000 grossed-up taxable value threshold for Public Benevolent Institution employees

It is significant to note that the above thresholds are not indexed to the Australian CPI and their value has therefore been eroded since introduction. It is equally clear that the value of these concessions will continue to erode unless the Review acts to preserve this through indexation of the threshold amount.

First Round Submission Applicant	Proposed amendment to FBT car concession
 <p>The St Vincent de Paul Society</p>	<p>“The indexing of the FBT exemption to average male weekly earnings would be a simple measure to ensure that the FBT exemption kept in line with wage movements. This would meet the government's objective in helping charities to attract competent staff. The indexation should occur with relation back to the date the capped threshold was set at \$30,000 per employee.”</p>

It cannot have been the legislative intention that this exemption be allowed to slowly lose value over time as the Australian economy grows – such a conclusion would be entirely contrary to its purpose. The NFP sector in Australia cannot afford to have the value of a

critical remuneration tool, one designed to assist them compete with commercial employers, erode whilst the private sector salaries with which they are competing continue to grow.

This submission proposes that the FBT threshold concession for the NFP sector be indexed annually in order to preserve its value. Furthermore, we submit that any indexation applied should be calculated from the date the threshold exemption was initially included in order to recover the value that has already been lost.

Key Message: In order to protect the value of the NFP FBT concessions, and therefore their usefulness to the NFP sector in attracting employees, the Review must recommend **annual indexation of the exempt threshold limits.**

Conclusion

This submission makes the following key points in relation to the application of FBT in Australia:

The FBT concession for cars:

- is in Australia's fundamental interests as it promotes economic activity within the motor vehicle and related industry sectors. The need for retention of this concession is particularly high in the current economic climate given current global financial crisis
- is necessary for Australian business efficiency: some form of concession must be retained in order to avoid complex 'Operating Cost Method' calculations for all employer-provided vehicles
- will result in the loss of a remuneration benefit that many Australian families depend on – particularly those at the lower end of the remuneration spectrum, and
- is a valuable policy tool that, with modification, can encourage Australian drivers and employers to make vehicle purchase and usage decisions that are not harmful to the Australian environment.

New FBT concessions should be considered:

- an FBT concession for public transport costs has the potential to deliver significant change to vehicle use patterns within Australia thereby assisting the government to pursue its stated environmental policy objectives, and
- An FBT concession for bicycle purchase costs, similar to the scheme underway in the UK, would deliver significant incentives for Australian workers to not only reduce their vehicle emissions, but also to embrace a more healthy and active lifestyle.

The not-for-profit sector FBT concessions:

- Should be retained within the FBT Act as Australian industry has built an effective framework through which this benefit is delivered directly to NFP industry employees, and
- Should be indexed to the CPI in order to prevent erosion of value, thereby preserving the level of assistance offered to the NFP sector.

Through adoption of the above points it is this submission's contention that the Henry Taxation Review can significantly improve and/or maintain the level of economic, environmental and community benefit arising from the application of taxation law.

18 December 2008



Dr Ken Henry AC
Secretary to the Treasury
The Treasury
Langton Crescent
PARKES ACT 2600
Australia

EXE 2008/2245

SECRETARY	OFFICE
22 DEC 2008	
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initial.....	
MR. HENRY	
CC: SECRETARY	

Dear Dr Ken Henry AC

For some time the Australasian Fleet Managers Association (AfMA) has been concerned with the current FBT system that is based on the 'more you drive the less you pay' principle for vehicles which is directly at odds with current declared Federal and State Government's initiatives of emission reduction.

Given the announced tax review to be conducted we have prepared a submission (see copy attached) recommending removing the inherent disincentives.

Your consideration of AfMA's submission and support for our recommendations would be greatly appreciated.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M-Thompson', written over a horizontal line.

Marja Thompson
Executive Director

***Dr Ken Henry AC
Tax Review***



***The Australasian Fleet Managers Association (AfMA)
Submission regarding Fringe Benefit Tax (FBT)
18 December 2008***

Introduction

The Australasian Fleet Managers Association Inc (AfMA) is a not for profit organisation representing some 550 members across Australia and New Zealand. Members of AfMA are responsible for the management of approximately 800,000 vehicles.

The Fleet industry plays a significant role at both a Federal and State economic activity level as Fleet sales account for in excess of 50% of all new vehicle registrations.

After their time as Fleet vehicles they are sold into the used retail market for a second life for an extended period of time. Purchasing decisions made by Fleets today will impact transport sector emissions output and vehicle safety for up to a decade after the initial acquisition.

The transport sector contributes some fourteen per cent of Australia's greenhouse gas emissions and is one, if not the only, segment that is expected to increase in the near future.

AfMA is a knowledge based organisation tasked with developing the professional status of fleet management and gathering and dissemination of best practice in the management of fleet from around the world.

As such AfMA disseminates information on best practice in the management of Fleet but does not sell services and products to its members or the industry in general and therefore has no vested interest in a FBT debate other than ensuring the adoption of effective and efficient Fleet Management outcomes.

Executive Summary

For some time AfMA has been concerned with the current FBT system that is based on the 'more you drive the less you pay' principle which is directly at odds with current declared Federal and State Government's initiatives of emission reduction and improving safety on our roads.

The current FBT regime not only runs counter to these objectives but it is AfMA's contention that FBT has become the single biggest barrier to the adoption of best practice on safety and emission reduction as FBT actively punishes organisations financially for adopting new technology and socially responsible practices.

AfMA recommends a realignment of the FBT statutory formula system placing an emphasis on encouraging the adoption of safety and emissions reduction technology by introducing a “the less you drive, the lower the FBT liability” approach. Vehicles with enhanced safety and/or reduced emissions features should be more financially attractive to Fleets not less.

There is an urgent need to reconcile the legislative conflicts that produce disincentives to allow Fleets to be at the forefront of a robust movement to substantially increase the number and range of safer and more environmentally friendly vehicles in the Fleet.

To remove the inherent disincentives of the current FBT system and simplify its administration AfMA recommends to:-

- ✓ Retain the logbook method for calculating FBT;
- ✓ Set the FBT statutory rate at a flat rate in the range of 11% to 16%;
- ✓ Include a nominal reduction in the FBT applicable price of the vehicle (the base for calculating FBT liability) so as not to discourage the adoption/inclusion of environmental and safety equipment/features, OR
- ✓ Provide a tax reduction for organisations adopting safety or emission reducing technology similar to the USA FET Incentives for Idling Reduction Units and Insulation or the proposed Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008, see attached synopsis.

If implemented, we see the above as addressing a number of negative issues associated with FBT i.e.

- ✓ It removes incentives to travel unwarranted distance;
- ✓ Does not discourage the uptake of safety features/standards in vehicles and therefore potentially reduces road trauma;
- ✓ It does not discourage the uptake in emission reduction technology in vehicles;
- ✓ It reduces the compliance costs for business in the administration of FBT;
- ✓ Should reduce the ATO’s audit and compliance costs.

Detailed Submission

Fleet vehicle selection decisions are driven from the perspective that they are an integral part of the organisation’s business activities with a defined cost. Often this cost can be the third largest financial liability to the organisation behind salaries and office accommodation.

A secondary function of Fleet is that it is the major source of vehicles into the used, second hand vehicle market. Purchasing decisions made by fleet today will impact the transport sector emissions output and vehicle safety for up to a decade after the initial acquisition.

The Australian Bureau of Statistics document S 9309.0 Motor Vehicle Census Australia, 31 March 2007 shows that average life for passenger vehicles was 9.7 years with 20% of all these vehicles being manufactured before 1992.

Fleet Managers have responsibility for and must balance the projected whole-of-life costs of vehicles, the relationship between the purchase and running costs, projected resale values, Stamp Duty and Fringe Benefit Tax.

For some time A/MA has been concerned with the negative effect and influence FBT has on fleet operations in that it has now become the single biggest barrier to the adoption of best practice on safety and emission reduction as FBT actively punishes organisations financially for adopting new technology and socially responsible practices.

The only incentive contained in the current FBT arrangements is that it encourages the practice of drivers travelling increased amounts of kilometres for no other justification than to reduce FBT liability.

Major obstacles to efficient Fleet Management are to be found in the conflicting objectives present in Federal and State Government environmental, road safety and taxation policies which are often at odds with current social attitudes and good corporate behaviour.

Our concern was heightened by a recommendation contained in the Bracks Report, which stated:-

“The Henry Review of taxation should consider the adoption of a new fringe benefits tax statutory rate table that is more evenly spread across the range of kilometres travelled. The new rate table would encourage drivers to use their vehicles only as necessary”.

While we support a review of the FBT statutory rate table, we view the recommendation in the Bracks Report as fundamentally flawed as it appears to be based on a narrow segment (novated leases), less than 9% (See page 4) of company acquired vehicles. Also this approach continues the basic premise of “the less you impact the environment, the greater the financial penalty administered to the organisation”.

The Bracks Report put forward a model for a revised FBT threshold system in its recommendations; Page 61 - Table 8.3: SG Fleet’s proposed statutory fractions. This proposed policy change, is purported to more evenly spread the FBT/kilometres band so as to encourage drivers to only use their vehicles as often as they need to.

Table 8.3 SG Fleet’s proposed statutory fractions

Kilometres travelled	Statutory fraction	*Cost new method	*Cost current method
0 to 14,000	26%	\$9,100	\$9,100
14,001 to 16,000	21%	\$7,350	\$9,100
16,001 to 18,000	19%	\$6,650	\$7,000
18,001 to 20,000	17%	\$5,950	\$7,000
20,001 to 22,000	15%	\$5,250	\$7,000
22,001 to 24,000	13%	\$4,550	\$7,000
24,001 to 26,000	11%	\$3,850	\$3,850
26,001 to 34,000	10%	\$3,500	\$3,850
34,001 to 40,000	9%	\$3,150	\$3,850
40,001 plus	7%	\$2,450	\$2,450

*These figures inserted by A/MA based on a vehicle cost for FBT purposes of \$35,000.

FBT: current statutory fraction percentages

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

In reality what is proposed in the Bracks Report, a structure in 2,000kms increments with a value of \$700 for each 2 degree step, provides more opportunities, not less, for cost reduction through additional travel. It would not be unreasonable to expect more vehicles to become involved in additional travel as more are likely to be within 1,000kms, or closer, to the next lower fraction band.

Under the above equation travelling to the next band using an additional 1,000 kilometres would result in a saving of \$520 per vehicle (\$700 minus (1,000kms at 12/100km @\$1.50 a litre = \$180)) or \$52,000 per 100 vehicles.

Much of the debate on FBT concentrates on the 'Novated Lease' arrangement with scant regard for the vast majority of other company vehicles. This is confirmed in the Bracks Report in that it describes the proposed statutory formula change as:-

"It does this by requiring drivers who use their vehicles less to pay a little bit more FBT, which is offset to a large extent by the reduction in running costs. The flipside means that the financial incentive to travel extra kilometres can be offset by the running costs involved in travelling the extra kilometres".

It is only when the vehicle is novated that the driver becomes wholly responsible for the vehicles running costs.

We note that the Bracks Report offered no data on what percentage of vehicles, subject to FBT, were acquired through a Novated lease process. Our data, derived from our yearly member survey, puts novated arrangements at less than 9% of the total number of fleet vehicles surveyed.

Percentage of total acquisitions financed by Novated Lease

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	Ave
Percentage	8%	8%	8%	8%	8%	8%	14%	9%	11%	8.56%

Source AfMA surveys 1999 through 2007

The adoption of new technology and cultural change practice is predisposed by the value of the incentive involved and the nature and size of the disincentives associated with its adoption. AfMA considers that it is unsustainable that initiatives to reduce emissions and road trauma are subject to a tax system that actively punishes businesses financially for taking positive action.

The dilemma for the Fleet Manager is that the current FBT system actively provides financial disincentives for the inclusion of enhanced safety and/or environmental initiatives into Fleet operations. For example, should a Fleet Manager purchase enhanced safety or environmental features, such as an LPG or diesel engine, it is likely to incur additional costs upwards of \$2,000.

This additional \$2,000 is then subject to stamp duty (a State tax) and FBT. Should an initiative to reduce emissions also be undertaken with an outcome of reducing kilometres travelled per year from above 25,000 kilometres to between 15,001 and

25,000 the additional costs to the organisation for being socially responsible, in the form of an increased FBT bill, is substantial.

For a Fleet of 100 vehicles and a three year ownership the additional costs become:

$\$2,000 \times 3\% \text{ stamp duty} \times 100 \text{ vehicles} = \$6,000 \text{ plus}$
 $\$2,000 \times 20\% \text{ FBT} \times 2.0647 \times 46.5\% \times 100 \text{ vehicles} \times 3 \text{ years} = \$115,209$
Sub total (cost for adding extra \$2,000 of equipment to a vehicle) = \$121,209

When the cost of reducing distance travelled is added the cost becomes:
Vehicle cost \$35,000 x 9% (the difference between 11% and 20%) \$3,150 x
100 vehicles x 3 years = \$945,000 x 2.0647 x 46.5% = \$907,280.

A three year ownership for 100 vehicles under the above scenario would cost an organisation an additional \$1,028,480 (\$121,200 + \$907,280) in FBT.

A/MA would suggest an overhaul of the FBT statutory formula system as in reality FBT has now become a burden to the effective management of Fleets. This is perhaps the most ironic, and counterproductive, element of FBT legislation; the inherent incentive to drive more, perhaps unnecessary, kilometres in order to minimise the tax payable and the disincentive to adopt best practice, safer and more environmentally friendly vehicles .

Vehicles with enhanced safety and/or reduced emissions features should be more financially attractive to Fleets not less. There is an urgent need to reconcile the legislative conflicts that produce disincentives to allow Fleets to be at the forefront of a robust movement to substantially increase the proportion of safer and more environmentally friendly vehicles on Australian roads.

This could be in the form of a nominal reduction in the FBT price of the vehicle (the base for calculating FBT liability) so as not to discourage the adoption/inclusion of environmental and safety equipment/features.

Alternately a tax reduction, similar to that proposed in the USA, could be given to organisations adopting emission reducing technology.

At both USA Federal and State levels, direct incentives are employed to encourage the uptake of new technology. Please see Attachment 1, a synopsis of the 'Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008'.

New FET Incentives for Idling Reduction Units and Insulation have also been introduced in the USA. The new financial rescue legislation created an exemption from the heavy vehicle excise tax for the cost of idling reduction units, such as auxiliary power units. The law also exempts the installation of advanced insulation, which can reduce the need for energy consumption by transportation vehicles carrying refrigerated cargo. Both exemptions are aimed at reducing carbon emissions.

To remove the inherent disincentives of the current FBT system and simplify its administration A/MA recommends to:-

- ✓ Retain the logbook method for calculating FBT;
- ✓ Set the FBT statutory rate at a flat rate in the range of 11% to 16%;
- ✓ Include a nominal reduction in the FBT price of the vehicle (the base for calculating FBT liability) so as not to discourage the adoption/inclusion of environmental and safety equipment/features, OR
- ✓ Provide a tax reduction for organisations adopting safety or emission reducing technology similar to the USA FET Incentives for Idling Reduction Units and Insulation or the proposed Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008, see attached synopsis.

If implemented, we see the above as addressing a number of negative issues associated with FBT i.e.

- ✓ It removes any incentive to travel unwarranted distance;
- ✓ Does not discourage the uptake of safety features/standards in vehicles and therefore potentially reduces road trauma;
- ✓ It does not discourage the uptake in emission reduction technology in vehicles;
- ✓ It reduces the compliance costs for business in the administration of FBT;
- ✓ Should reduce the ATO's audit and compliance costs.

At a basic level the adoption of new technology is predisposed to two sets of influences; the incentive and/or the disincentive. A sought-after outcome can be achieved without the need to provide an incentive. More importantly however, the removal of disincentives, such as those that currently negatively influence purchase decisions, is necessary to positively influence change.

FBT has become a vicious circle of multi level economic disincentives. As organisations seek to enhance safety, reduce emissions and/or costs the Fleet becomes problematic as any reduction in fuel and distance travelled translates into a higher FBT bill. FBT has outstripped its original raison d'être and has become a burden to the effective management of Fleets.

Summary

FBT has now become a burden to the effective management of Fleets. This is perhaps the most ironic, and counterproductive, element of FBT legislation; the inherent incentive to drive more, perhaps unnecessary, kilometres in order to minimise the tax payable and the disincentive to adopt best practice, safer and more environmentally friendly vehicles .

The current FBT system runs counter to declared Federal and State Government's initiatives of emission reductions and efforts to increase safety on our roads.

A/MA recommends the overhaul of the FBT statutory system to a flat rate of between 11% to 16% and either a nominal reduction in the FBT price of the vehicle or to provide a tax reduction for organisations adopting safety or emission reducing vehicle technology similar to the USA system.

Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008 (Introduced in Senate)
S 3428 IS

110th CONGRESS
2d Session

S. 3428

To amend the Internal Revenue Code of 1986 to provide a credit against income tax to facilitate the accelerated development and deployment of advanced safety systems for commercial motor vehicles.

IN THE SENATE OF THE UNITED STATES August 1, 2008

Ms. STABENOW (for herself, Mr. VOINOVICH, and Mrs. DOLE) introduced the following bill; which was read twice and referred to the Committee on Finance

Extract

SEC. 45Q.

CREDIT FOR COMMERCIAL VEHICLE ADVANCED SAFETY SYSTEMS.

- (a) Allowance of Credit- For purposes of section 38, the commercial vehicle advanced safety system credit determined under this section is an amount equal to 50 percent of the cost of any qualified commercial vehicle advanced safety system placed in service by the taxpayer during the taxable year.
- (b) Limitations-
- (1) PER SYSTEM- The credit allowable under subsection (a) for each qualified commercial vehicle advanced safety system shall not exceed \$1,500.
 - (2) PER VEHICLE- The credit allowable under subsection (a) with respect to property for each qualified commercial vehicle shall not exceed--
 - (A) \$3,500, reduced by
 - (B) the aggregate amount of credit allowed to the taxpayer under this section with respect to such vehicle for all prior taxable years.
 - (3) PER TAXPAYER- The credit allowable under subsection (a) to the taxpayer for the taxable year shall not exceed \$350,000.
- (c) Qualified Commercial Vehicle Advanced Safety System- For purposes of this section, the term 'qualified commercial vehicle advanced safety system' means any property which is part of a system installed on a qualified commercial vehicle if--
- (1) (A) such system is a brake stroke monitoring system, lane departure warning system, collision warning system, or vehicle stability system, or
(B) such system is specifically identified by the Administrator of the Federal Motor Carrier Safety Administration or the Administrator of the National Highway Traffic Safety Administration for the purposes of this paragraph as significantly enhancing the safety or security of the driver, vehicle, passengers, or load of a qualified commercial vehicle and such identification is in effect as of the date such system is placed in service by the taxpayer,
 - (2) such system is certified by the manufacturer of such system (before such vehicle is first used by the taxpayer for its intended purpose after installation of such system)--
 - (A) to be appropriate for the make, type, and model of the qualified commercial vehicle on which it is to be installed, and
 - (B) to function as designed if installed properly,
 - (3) in the case of a system which is not installed by the manufacturer of the qualified commercial vehicle or by an installer authorized by the manufacturer of such system, such system is certified by the installer of such system to be properly installed and functioning on the vehicle before such vehicle is first used by the taxpayer for its intended purpose after installation of such system,
 - (4) the original use of such system begins with the taxpayer, and
 - (5) depreciation (or amortization in lieu of depreciation) is allowable with respect to such system.

16 March 2009

McMillan Shakespeare Limited
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AFSL No. 299054

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AFTS Secretariat
The Treasury
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PARKES ACT 2600

Email: AFTSubmissions@treasury.gov.au

Dear Sir/Madam,

Please find attached our further submission to the Review Panel from McMillan Shakespeare Limited. This submission updates, further developed and provides analysis and modelling following the reviews consultation paper issued in December 2008.

McMillan Shakespeare would welcome the opportunity to present to some or all of the members of the Review to add further detail and insight to this submission.

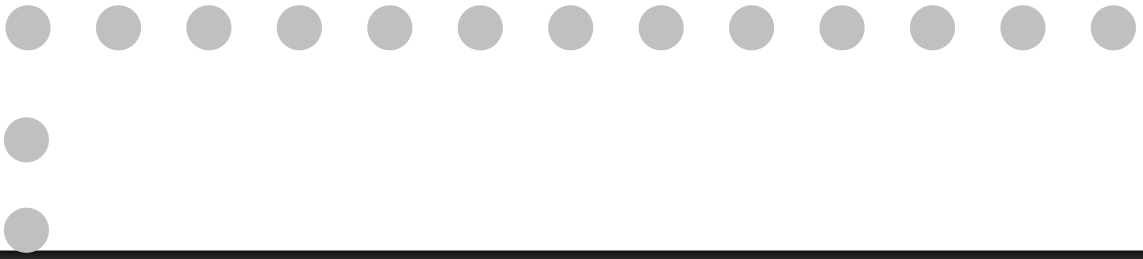
McMillan Shakespeare has provided confidential commercial in confidence material in this submission and requests that it not be published on the AFTS website until we have had the opportunity of presenting to the review.

Please contact Anthony Podesta on 03 9635 0100 or anthony.podesta@mcms.com.au.

Yours sincerely
MCMILLAN SHAKESPEARE LIMITED



Anthony Podesta
Director



McMillan Shakespeare Limited

**Submission to the Review of
"Australia's Future Tax
System" - (Henry Review)**

COMMERCIAL IN CONFIDENCE
NOT FOR PUBLICATION

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1. Executive Summary

McMillan Shakespeare Limited (**McMillan Shakespeare**) is the leading provider of novated leased motor vehicles in Australia. We have approximately 30,000 motor vehicles under lease and have a very extensive statistical database. As there appears to be little data available on the "company car" (benefit vehicles) sector, we have taken the view that we should provide our information, research and data to the Henry Review (**the review**) in the interests of fully informed public policy making by government.

This submission addresses issues only in relation to fringe benefits tax for motor vehicles provided to employees by their employer in relation to the employee's remuneration.

Our submission specifically addresses the questions raised in the review's Consultation Paper¹ issued in December 2008:

Q4.6 How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?

Q13.1 Bearing in mind that tax is one of several possible instruments that can address environmental externalities, what opportunities exist to use specific environmental taxes to address Australia's environmental challenges?

Q13.2 Noting that many submissions raise concerns over unintended environmental consequences of taxes and transfers, such as the fringe benefits tax concession for cars, are there features of the tax-transfer system which encourage poor environmental outcomes and how might such outcomes be addressed?

Q13.3 Given the environmental challenges confronting Australian society, are there opportunities to shape tax-transfer policies which do not currently affect the environment in ways which could deliver better environmental outcomes?

There are many stakeholders in the issues raised by these questions. In particular, the review's recommendations need to take into account the interests of the motor vehicle industry, environmentalists, employers, employees, trade unions and government policy.

Our submission tries to take these many and varied interests into account, to find common ground and to recommend some innovative solutions that can underpin good Government policy. We have also tried to balance short and long term objectives.

We have consulted widely in relation to our recommendations and believe that we have the support of the broader motor vehicle industry, the Australian Conservation Foundation and other significant interest groups.

In developing our options and recommendations, we have been conscious of the need to assess and consider:

- the impact on the environment;
- the impact on FBT / ATO revenue;

¹ Australia's future tax system Consultation paper December 2008

- Vehicle demand – industry viability;
– jobs.
- the Federal Government’s initiative released in November 2008, “*A new car plan for a Green future*”.

As a result of our research and analysis, “marketplace testing” and the economic modeling carried out on our behalf by Access Economics and Lateral Economics, we have concluded and therefore recommend the following:

- The fringe benefits taxation concession for “Company” motor vehicles (benefit motor vehicles for employees) is a critical driver of new motor vehicle sales (demand). **Removal of the FBT concession is likely to significantly reduce demand for motor vehicles and will have a disproportionate effect on Australian made motor vehicles as they make up a disproportionately large number of benefit vehicle sales.**
- **The FBT formula should be redesigned so that it is linked to the environmental rating of the motor vehicle and not the kilometres driven.** Our recommendations will reduce carbon emissions of company cars by up to 20% or 1 tonne per motor vehicle, whilst preserving the demand for motor vehicle production and government revenue.
- **There needs to be a “transition phase” for implementing a new “green” FBT formula linked to the environment in order to avoid short-term sales damage to the local Australian Motor Vehicle manufacturers whilst they design and build “green” cars.** This will also allow adequate time for employers and employees to plan for and have a “run-off” before a new FBT formula is implemented.
- **Finally, the call from some quarters to tax fringe benefits in the hands of employees rather than employers should be rejected.** It is likely to create expensive, dual administration and compliance tasks and add new burdens to the circa 1 million employees who receive fringe benefits versus the collection of FBT from 69,000 employers currently who submit FBT returns. It is also likely to make the ATO’s collection effort more complex, expensive and less effective.

In summary, we believe our submission demonstrates that these recommendations will complement the Federal Government’s initiatives for “*A new car plan for a green future*” by reducing Carbon emissions of company benefit motor vehicles whilst simultaneously supporting locally produced motor vehicle sales. Our recommendations will underpin the preservation of crucial skills and jobs in the manufacturing and related sectors and incentivise manufacturers and consumers to take advantage the Government’s a new car plan. **Finally, our recommendations will not erode Government FBT revenue.**

2. History and Background of FBT Concession for Motor Vehicles

- 2.1 Fringe Benefit Tax (**FBT**) was introduced in 1986 to enable non-cash benefits provided to employees by their employer to be taxed. The taxing of any benefits being derived from the provision of such motor vehicles to employees.
- 2.2 FBT on motor vehicles was introduced to ensure the benefit was appropriately based whilst at the same time, supporting the demand side of Australian motor vehicle manufacturing industry.
- 2.3 In the late 1990's the use of novated leasing to provide vehicles to employees by their employer began to take place through all levels of the Australian workforce in both the private and public sectors.
- 2.4 The popularity of novated leasing has enabled all employees the choice to include a motor vehicle in their remuneration package and has enabled employers to reduce their risk of unwanted vehicles on their balance sheet.
- 2.5 During the 1990's industrial awards, agreements, collective agreements or similar were negotiated to include provisions for "flexible salary packaging". Many thousands of awards were varied and agreements made to "allow" for the first time 'award based' employees to participate in flexible salary packaging arrangements. Virtually all industrial instruments contained provisions for employees to salary package. The introduction of the novated lease helped to facilitate and accelerate employees into salary packaging. Effectively employees at the "rank and file" award level within the organisation have access to salary packaging and the "company car" via a novated lease. Our data shows that 50% of employees with a novated lease earn less than \$75k per annum. The "company car" was no longer the exclusive domain of the executive, senior manager. Even for executives that were traditionally provided with a "company car" now had a choice of the make, model and colour under a novated lease rather than the choice of a white Holden Commodore or a Ford Falcon.
- 2.6 The availability of an employer provided vehicle through a novated leasing arrangement has become a standard feature of employment agreements between employers and employees any change to the current FBT arrangements may require employers to renegotiate these agreements with their employees.
- 2.7 From 1986 to the mid 1990's vehicles were generally only provided to executives as part of their remuneration package. Most employees did not receive access to a company vehicle as part of their remuneration package. But since then, the situation has radically changed.
- 2.8 Contrary to the public perception (undoubtedly a hangover from the past) the vast majority of novated leases are taken out by working families. Some telling statistics from our database:
 - Around 3% of McMillan Shakespeare's novated leases are for cars with a value in excess of the luxury tax threshold.
 - The average value of vehicles purchased is \$37,900.
 - 50% of customers taking out a novated lease earn less than \$75,000p.a.

In other words novated leases provide a means and an effective incentive to buy a new vehicle. And that is good for both the environment and the Australian manufacturing sector and related upstream and downstream industries. Some more important statistics:

- Vehicles purchased by novated lease is a large and growing sector of new vehicle sales; we estimate 28%.

- Australia manufactured vehicles are disproportionately represented in the novated leasing sector (11% of all vehicle sales; 21% of novated leases).
- Novated leases incentivise people to buy new cars. New cars in general produce fewer emissions than older cars².

3. Benefit Vehicles – The Current FBT Regime

3.1 The Fringe *Benefits Tax Assessment Act 1988* (**FBTAA**) requires employers to pay FBT on various benefits provided to their employees.

3.2 The provision of a motor vehicle by the employer to an employee is considered to be a taxable benefit. To calculate the FBT payable on a motor vehicle benefit, the employer must determine the taxable value of the vehicle. There are two methods for determining the taxable value of a vehicle:

(i) The operating cost method (**OCM**);

Taxable Value = (A x B) – C where:

A = the total operating costs

B = the percentage of private use, and

C = the employee contribution.

(ii) The statutory formula method (**SFM**).

Taxable Value = A x B x C/D – E where:

A = the cost value of the car

B = the statutory percentage

C = the number of days in the FBT year when the car was used or available for private use of the employee

D = the number of days in the FBT year

E = the employee contribution (if any)

The following table sets out the percentages used in the calculation of the Taxable Value:

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

3.3 Irrespective of the formula used to determine the taxable value of the vehicle, the Fringe Benefits Tax (FBT) of the motor vehicle provided to the employee by the employer is calculated using the following formula:

² Public discussion paper, vehicle fuel efficiency – potential measures to encourage the uptake of more fuel efficient low carbon emission vehicles – September 2008

$$FBT = \text{Taxable Value} \times \text{Gross-up factor} \times \text{FBT rate}$$

3.4 The ATO statistics from 2006-07 indicate that the most popular method for determining the taxable value of a vehicle is the SFM (68 %) and that 92% of FBT revenue collect for cars is from the SFM. This is because of the simplicity of the SFM including the reduced record keeping requirements. Additionally, the majority of our customers choose to use the Employee Contribution Method (ECM) to meet their residual tax obligation.

3.5 With the changes to personal tax rates since 1986 there has also been a significant increase in employee contributions to reduce the taxable value of benefit vehicles to zero:

The highest proportion of employee contributions was for Cars – statutory, with 75.9% of employers receiving employee contributions. This represented 74.6% of the total \$452 million of employee contributions.

3.6 There are a number of stakeholders in the current FBT arrangements for benefit vehicles. The following table lists the advantages for each of the major stakeholders.

Stakeholder	Advantages
Employer	<ul style="list-style-type: none"> ▪ Tax concessions (lower costs). ▪ Simple administration. ▪ Recruitment and retention tool. ▪ Able to reduce the size of the “fleet” and subsequent risks by adopting novated leasing.
Employees	<ul style="list-style-type: none"> ▪ Tax concession (lower costs). ▪ Remuneration benefits. ▪ Choice of motor vehicle.
ATO	<ul style="list-style-type: none"> ▪ Simple administration. ▪ High level of compliance. ▪ More efficient than dealing with individual employees.
Motor Vehicle Industry	<ul style="list-style-type: none"> ▪ Increased sales. ▪ Jobs. ▪ Industry viability.
Environmentalists	<ul style="list-style-type: none"> ▪ More new vehicles are on the road replacing older vehicles which are likely to have lower emissions.

3.7 The current regime is working for most of the stakeholders.

3.8 The major criticism of the existing FBT formula, is that it encourages’ greater kilometres travelled. This in turn impacts negatively on the environment. However, in practice, any extra unnecessary kilometres driven that result in a reduction of FBT otherwise payable, is “offset” by high fixed costs, wear and tear (depreciation) and time costs. In reality, our evidence suggests that few employees of benefit/company motor vehicles actually drive extra kilometres. Rather, false, inaccurate or misleading odometer readings (especially related to fuel cards as the basis for calculation) are much more likely to prevail at FBT year end.

4 Novated Leasing

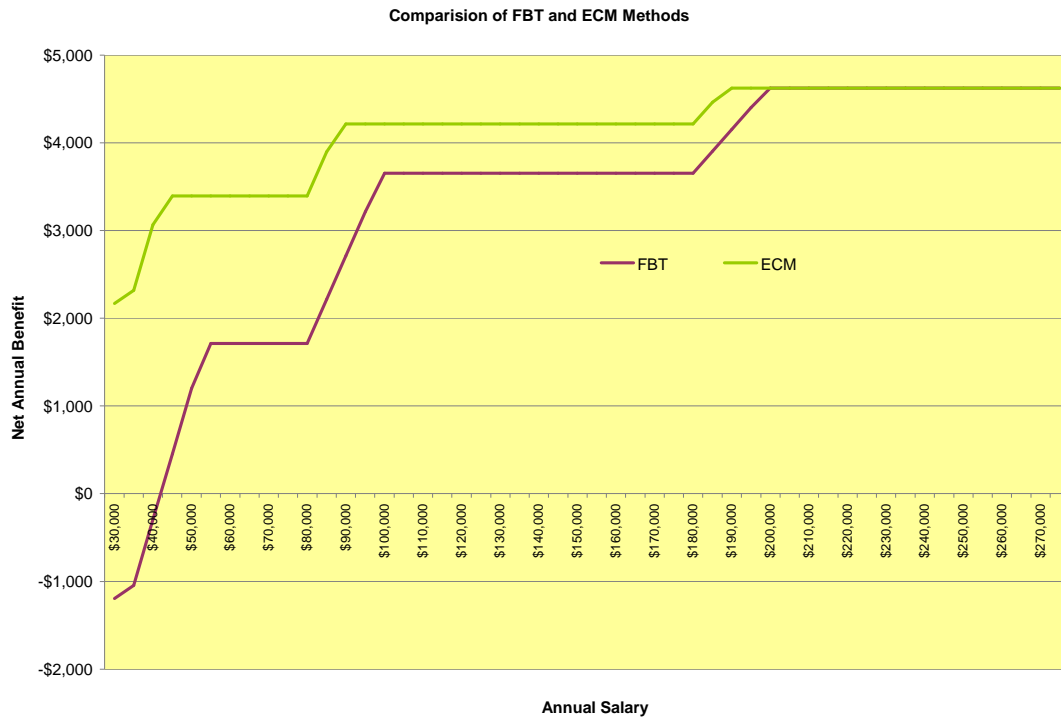
- 4.1 Since about 1995, employers have increasingly been using novated leasing arrangements to provide employees with motor vehicles as part of their salary packaging arrangements.
- 4.2 Under a novated lease, an employee leases a vehicle from a financier using a standard finance lease agreement. The employee, the employer and the financier then enter into a novated lease, which transfers to the employer for the term of the lease:
- the employee's obligation to pay the lease payments;
 - the right to use the vehicle; and
 - other obligations under the finance lease.
- 4.3 Novated leasing of motor vehicles has been in place for about 15 years and is supported with taxation rulings from the Australian Taxation Office (ATO).
- 4.4 Novated leasing is widely available in both the public and private sector, Australia wide.
- 4.5 The main benefits for an employee of a novated lease are:
- Savings through salary packaging the operating and lease costs of the vehicle;
 - Choice of vehicle to meet their needs;
 - The opportunity to buy a new vehicle every 3/ 4 years;
 - Choice in structuring their remuneration in a way that suits their personal and family requirements; and
 - Capacity to access fleet discounts in relation to vehicle pricing, fuel and maintenance.
- 4.6 The main benefits for the employer of a novated lease are:
- Effective way of providing employee benefits;
 - Assists in the retention and attraction of employees;
 - Bargaining tool for employment agreements; and
 - Eliminates the risk of having 'unwanted' company vehicles on the fleet thereby reducing costs.

4.7 The following example illustrates the remuneration benefit of a novated lease to an employee.

Item	No Salary Packaging	Salary Packaging FBT Method	Salary Packaging Employee Contribution Method
Salary	\$50,000	\$50,000	\$50,000
Lease / Running Costs	\$0	-\$15,000	-\$9,000
Fringe Benefits Tax	\$0	-\$5,761	\$0
Input Tax Credits	\$0	\$1,364	\$1,364
GST on Employee Contributions	\$0	\$0	-\$545
Net Salary	\$50,000	\$30,603	\$41,818
Tax & Medicare	-\$9,750	-\$4,150	-\$7,173
Net Cash Salary	\$40,250	\$26,454	\$34,646
Lease / Running Costs	-\$15,000	\$0	\$0
Employee Contributions	\$0	\$0	-\$6,000
Net Benefit Salary	\$25,250	\$26,454	\$28,646
Net Benefit		\$1,203	\$3,395

- The lease has a residual of 45%. and a term of three years.
- The annual lease and operating costs (insurance, registration, fuel, roadside assistance etc) are \$15,000.
- The vehicle travels 20,000 km per annum.
- All input tax credits are refunded to the employee's salary package.
- The Net Benefit is calculated as the difference in making payments with and without salary packaging.
- The Statutory formula is used to determine taxable value.

4.8 The following chart provides an illustration of the benefit for a range of salaries:



5 Market Size and Statistics – Benefit Vehicles

5.1 It is difficult to find accurate data on the number of benefit vehicles in Australia. However using a variety of sources and industry information, McMillan Shakespeare estimates that there are about 600,000 to 700,000 vehicles.

5.2 The report³ published by the Department of Industry, Science and Resources in July 2000 estimated that the total number of cars and light commercial vehicles in fleet use to be approximately 1.3million. The report also broke down the fleet market into the following categories:

- Tools of trade vehicles – vehicles dedicated to a job such as plumbers' and electricians' vans;
- User chooses – vehicles where the executive has a range of vehicles to choose from;
- Pool vehicles – pool vehicles are vehicles that are generally driven by more than one driver.

5.3 The report also provides an estimate of the number of vehicles in each of the categories:

- Tools of Trade - 30%;
- User Chooses - 40%;

³ Industry, Science and Resources Energy Efficiency Best Practice Program July 2000

- Pool - 30%.

5.4 The following factors have traditionally influenced the choices made by fleet operators.

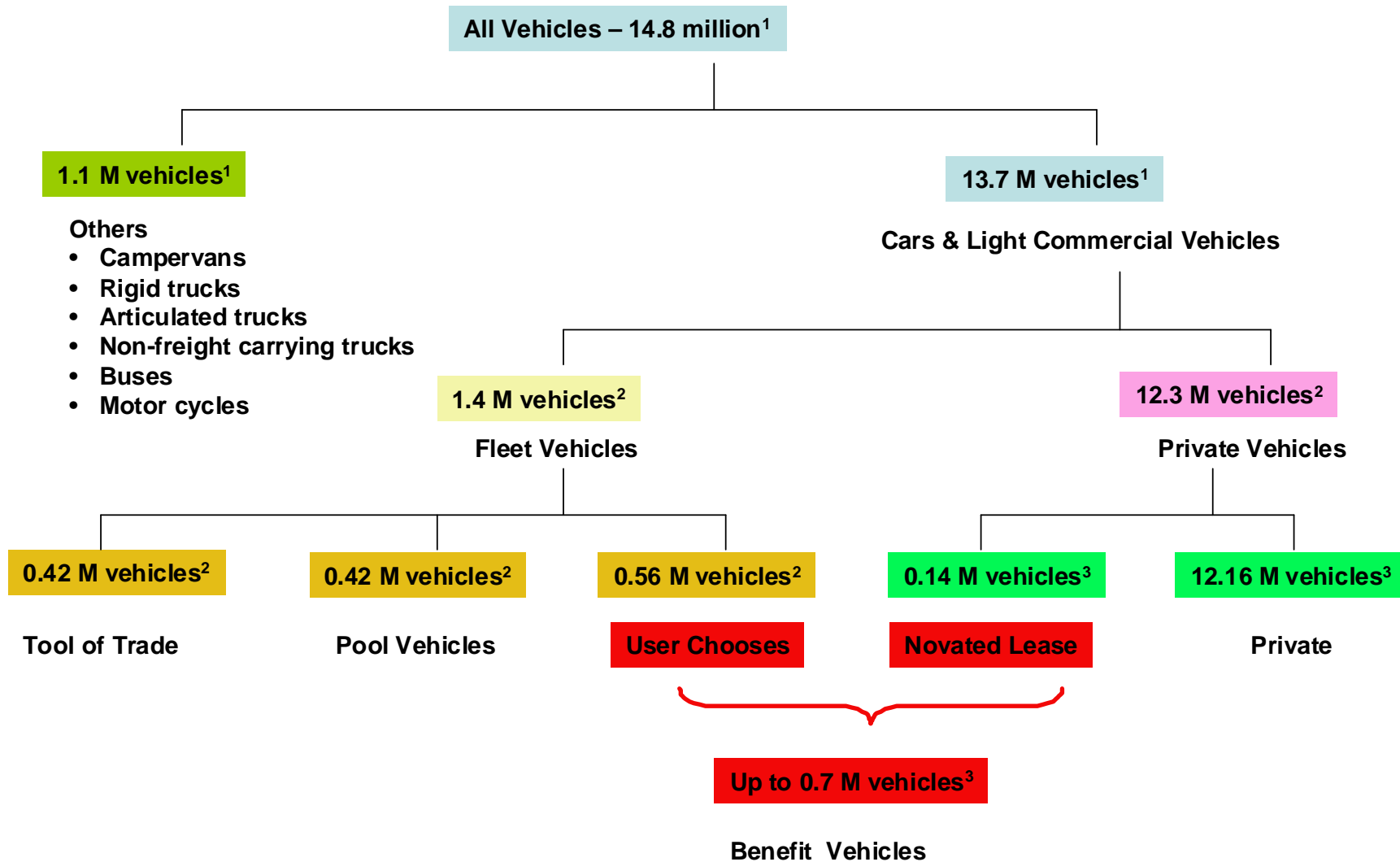
- The great **Australian tradition**. There is a very strong tradition in the industry that a 'real' car is a 6-cylinder Holden or Ford.
- **Local discounts** - the favourable economics of producing large volumes for the local market mean that manufacturers are able to offer substantial discounts of up to 30% for local volume purchasers. This tends to act to entrench industry vehicle choices.
- **Salary packaging** - the inclusion of vehicles in salary packages is routine for employees because industrial agreements or similar accommodate such arrangements and tax savings can be achieved.
- **Compliance** - vehicles must comply with a number of requirements. Some examples are legislative requirements for weight carrying capacity, number of passengers, and union requirements for safety.
- **Fitness for purpose** - vehicles selected for fleet use must be fit for their intended purpose. For example station wagons are likely to be necessary for salespeople carrying samples in the outback and small maneuverable cars are likely to be required for town deliveries.

Note: Environmental considerations and even fuel efficiencies in vehicle selections have been almost non-existent up until very recent times.

5.5 We estimate that of the 14.8 million vehicles in Australia about 600,000 to 700,000 are benefit vehicles. In 2007 of the 640,000 passenger vehicle sales approximately 177,000 were benefit vehicles and 69,083 were Australian made. The following table and diagrams provides a summary of statistics for the motor vehicle industry in relation to benefit vehicles for the 2007 year and in relation to Australia's car fleet:

New Motor Passenger Sales	640,000
Benefit Vehicle Sales (all Cars)	176,659
Novated Leases (privately registered)	46,667
Government Benefit Vehicles	16,000
Non Government Benefit Vehicles	113,993
Australian Made Benefit Vehicles	69,083
Novated Leases (privately registered)	9,333
Government Benefit Vehicles	14,850
Non Government Benefit Vehicles	44,900

Australia's Car Fleet - 2007



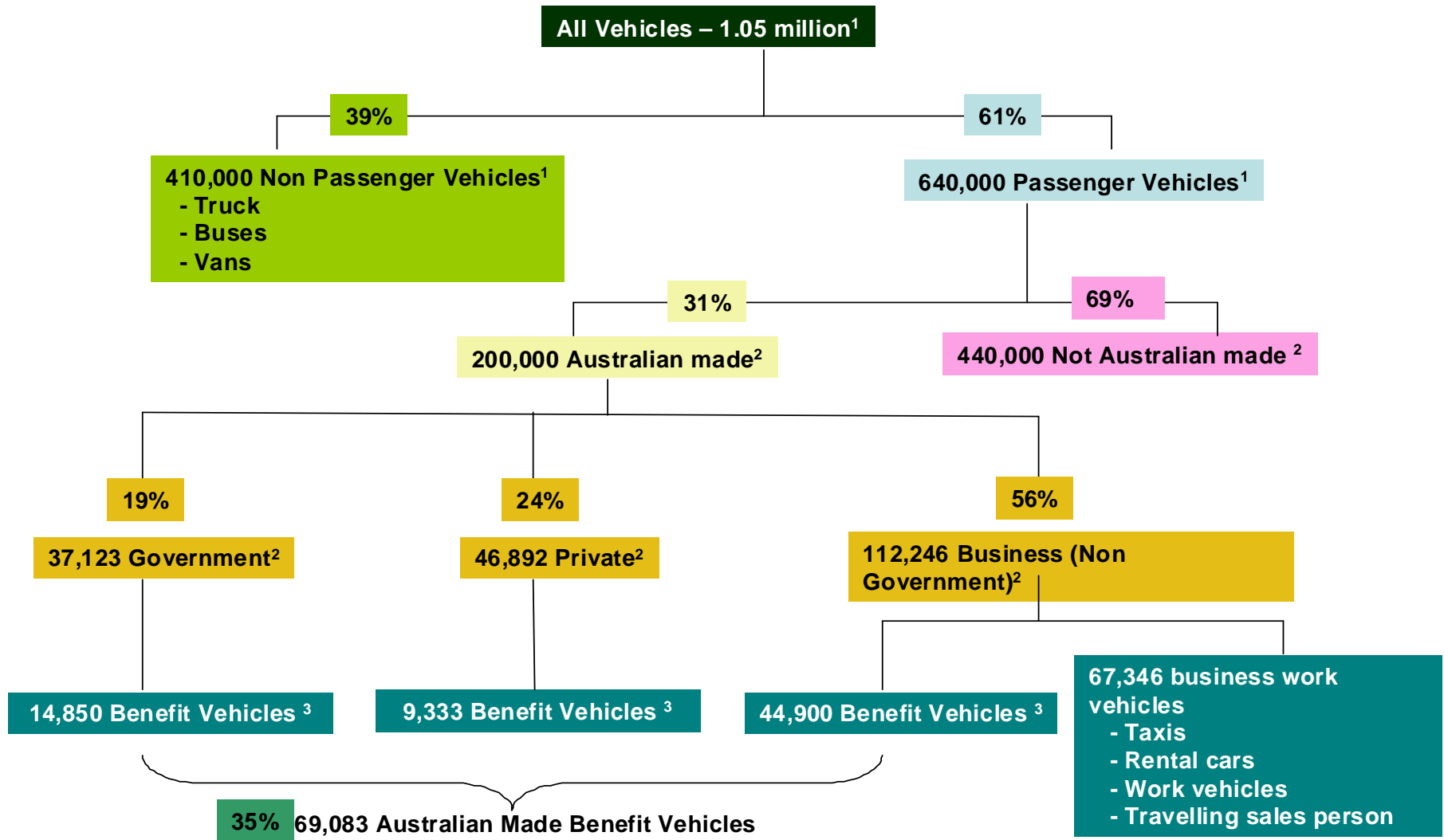
Definitions

Light Commercial vehicle means a commercial vehicle up to 3.5 tonnes.
 Tools of Trade vehicles means vehicles dedicated to a job eg plumber's van.
 User Chooses means vehicles provided to an employee.
 Pool vehicle means a vehicle driven by more than one driver

Notes

1: ABS Vehicle Census 007 – 9309.0
 2. Estimate based on Energy Efficiency Opportunities In Fleet Management , July 2000, Department of Industry, Science and Resources
 3. McMillan Shakespeare estimate

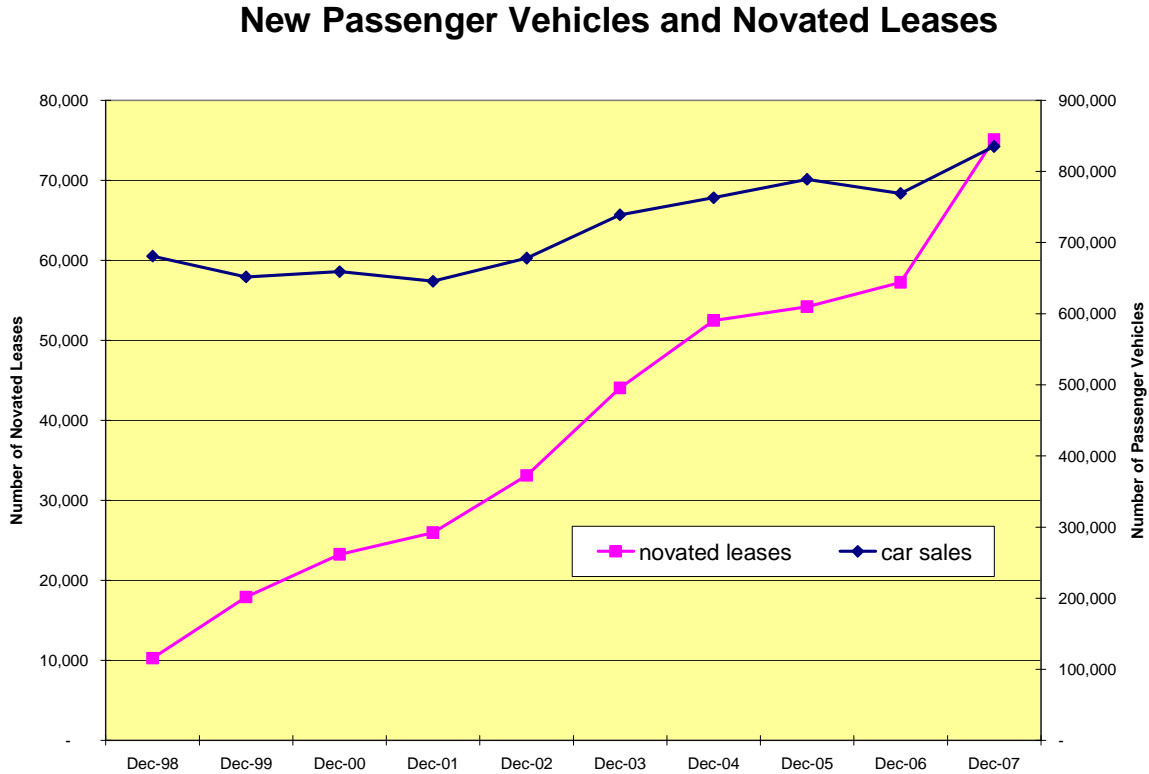
New Motor Vehicle Sales - 2007



Notes

- 1. FCAI
- 2. Background Paper – Review of Australian Automobile Industry
- 3. McMillan Shakespeare estimate

5.6 Novated leasing of motor vehicles contributes a significant portion of new motor vehicle sales. The following chart demonstrates the numbers of novated lease vehicles is increasing at a rate of 20% per annum.

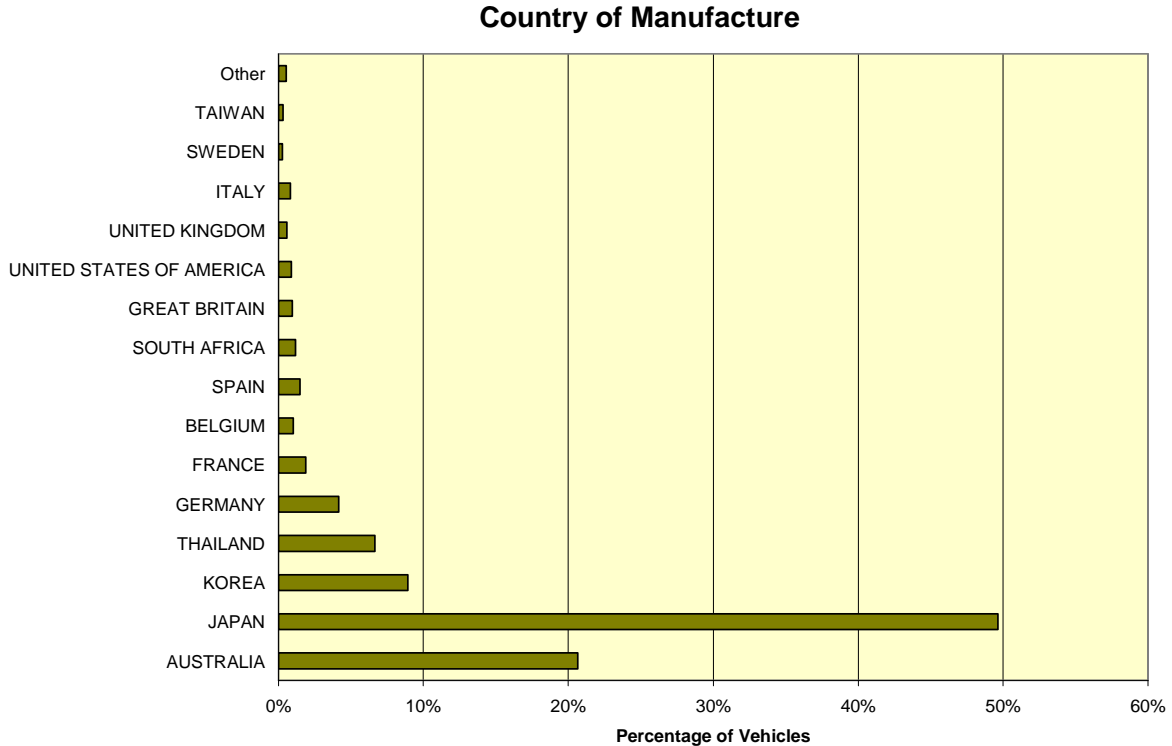


- Number of Passenger Vehicles – ABS - 9314.0 - Sales of New Motor Vehicles, Australia, Jun 2008
- Number of Novated Leases – Australian Fleet Lessors Association – December 2007

5.7 There were a total of 69,083 Australian made benefit motor vehicles out of 176,659 benefit vehicles in 2007. This represents 39% share of the benefit sector as opposed to a 20% share of the total market.

5.8 In fact, the total number of private (total non-business) Australian manufactured vehicle sales is only 37,500 out of the 200,000 motor vehicles produced (less than 20%). By any reasonable measure, "Company" business use, benefit motor vehicle sales are critical to the Australian motor vehicle industry. Therefore, any changes to FBT will need to be very carefully considered to avoid unnecessary negative impacts.

5.9 The utilisation of novated leasing is a significant component of the demand for Australian made vehicles. 21% of the vehicles administered by McMillan Shakespeare as novated leases are Australian made vehicles (only 11% of consumers purchased Australian made vehicles passenger vehicles in 2007.)



Source: McMillan Shakespeare Client Base

5.10 The Government has a commitment to the Australian made motor vehicle industry. The Minister for Innovation, Industry, Science and Research, Senator Kim Carr, stated on 15 August 20084:

The automotive industry is strategically critical to Australia in terms of exports, employment and innovation. Our economy benefits from the investment, jobs, skills, research and development, innovation and the exports the industry generates.

5.11 It is likely there will significant affects to the Australian economy and unemployment rate if the Australian motor vehicle industry (and those upstream and downstream businesses connected to it) is impacted by a reduction in new car sales. The use of novated leasing by employees is a key source of demand in relation to the number of sales of Australian made motor vehicles.

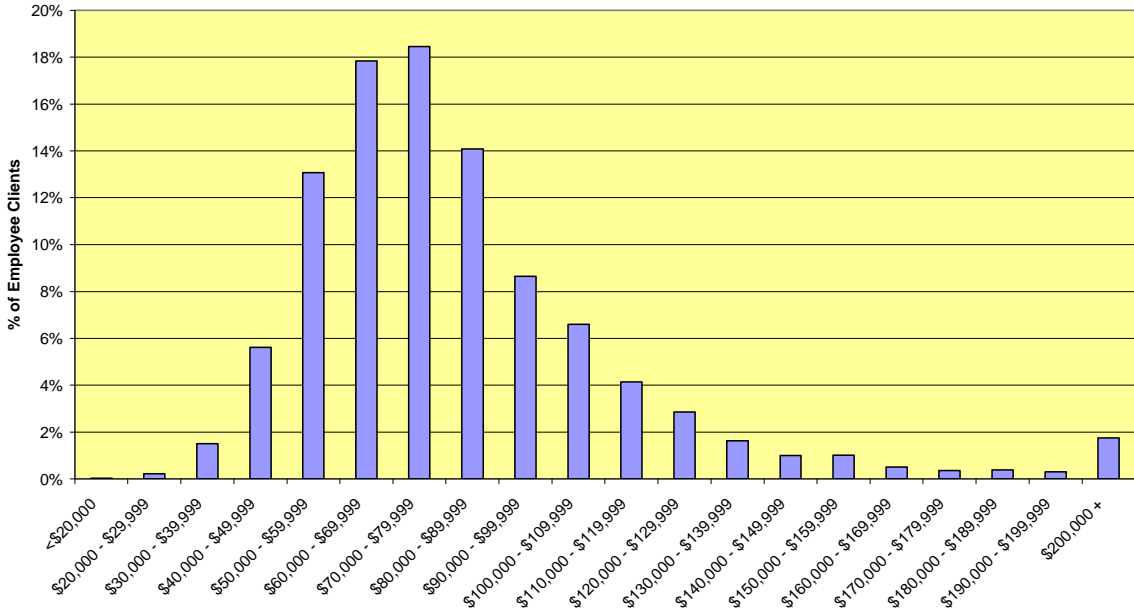
5.12 Novated leasing provides a cost effective way for working Australians to buy a new vehicle which may not be possible if purchasing or financing a new vehicle was the only option.

5.13 Accordingly, the removal of tax concessions for novated leasing would have a greater impact on working Australians than highly paid executives who have the resources to purchase or finance a new vehicle and easier access to increased remuneration to take account of any tax change which may affect their remuneration.

4 Senator the Hon Kim Carr 15 Aug 2008 Media Release - Bracks' Report Maps Auto Future

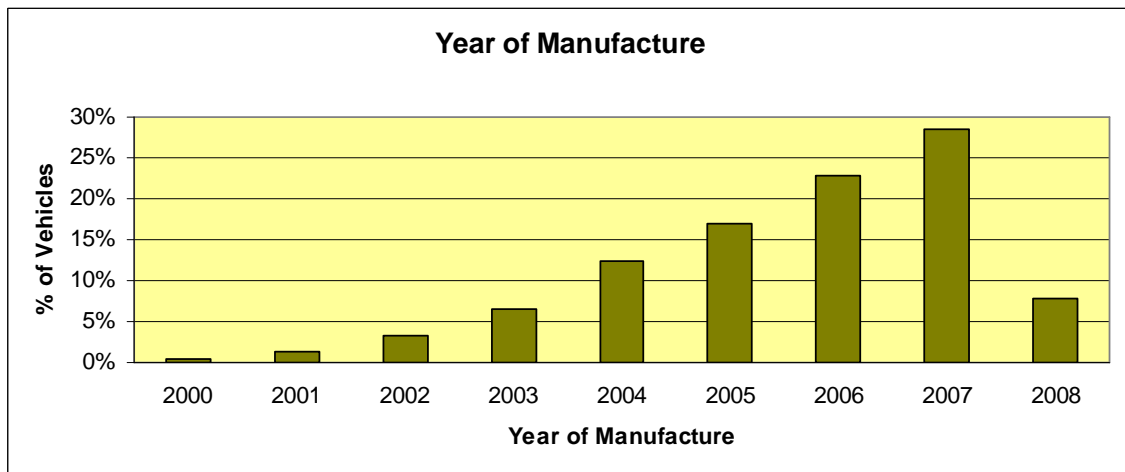
5.14 50% of employees who salary package a car have a salary of less than \$75,000.

Salary Distribution - Car Benefit (Novated Lease)



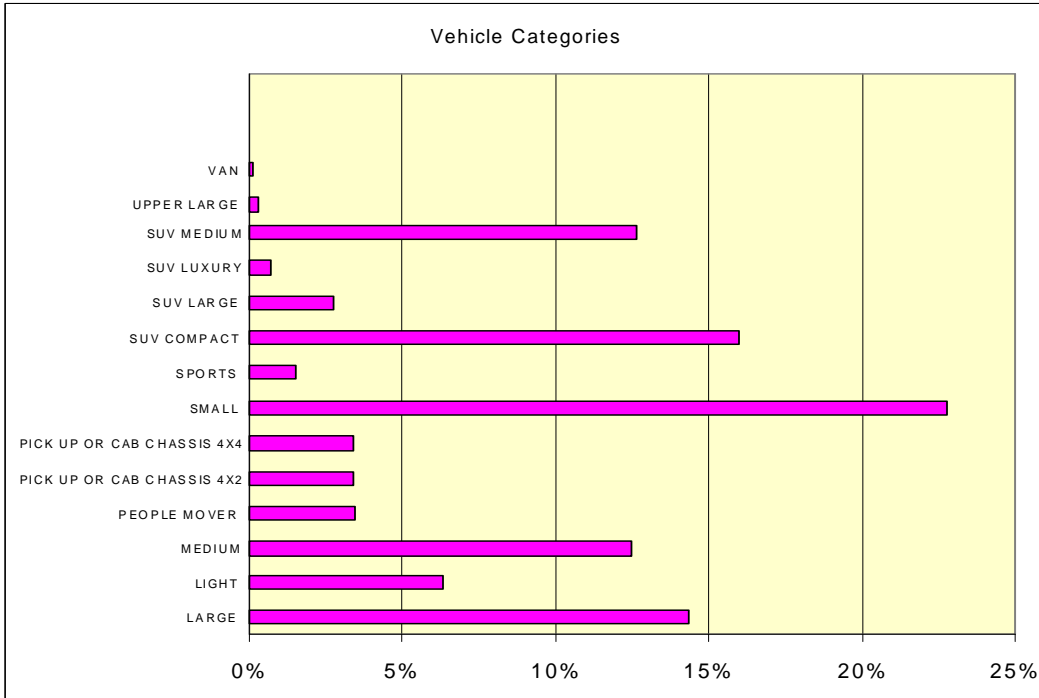
Source: McMillan Shakespeare Client Base

5.15 The average age of a novated lease vehicle is 2.5 years and is more likely to create lower emissions than the average vehicle on the road which is more than 10 years old. Salary packaging creates incentives for people to drive newer cars which are more likely to be less polluting and safer than older cars. These outcomes are significant public and economic goods.



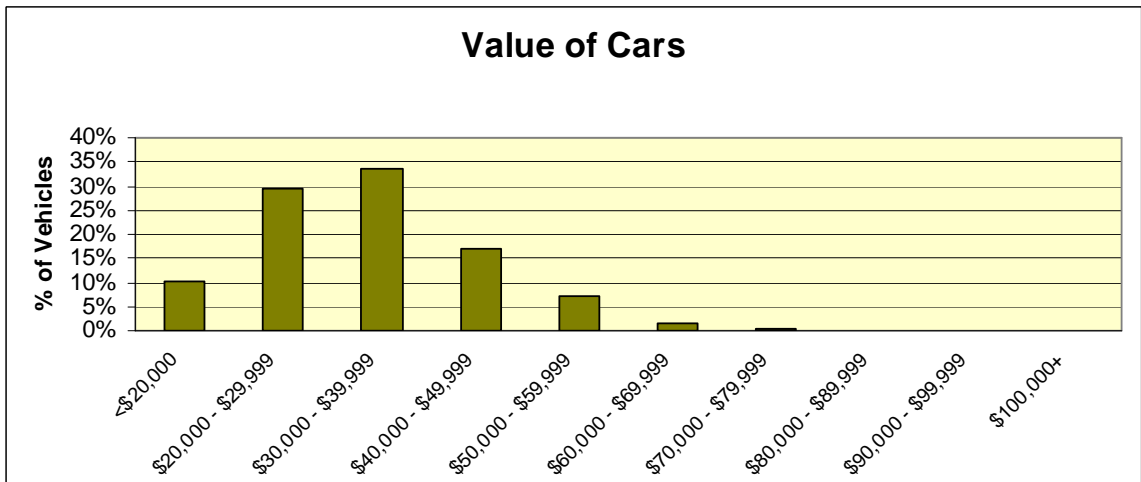
Source: McMillan Shakespeare Client Base

5.16 Two thirds of the vehicles administered by McMillan Shakespeare are small or medium sized vehicles.



Source: McMillan Shakespeare Client Base

5.17 The average value of a vehicle administered by McMillan Shakespeare as a novated lease is \$33,900 and only 3% of the vehicles have a value that exceeds the luxury car tax threshold.



Source: McMillan Shakespeare Client Base

6 Environmental Issues

- 6.1 In a speech to the National Press Club on 9 April 2008, Don Henry, Executive Director, the Australian Conservation Foundation stated that the Government should restructure the fuel tax credits scheme (costing \$4.9 billion a year), and do away with the tax break for aviation fuel (\$900 million) and the fringe benefits tax concession for personal use of company cars (more than \$2 billion a year by 2009-10).

The fringe benefits tax break for company cars invisibly chugs out just as much greenhouse pollution every year as a medium-sized coal-fired power plant, only the fringe benefits tax break for company cars doesn't produce any energy. It's just a dead weight on the economy, the Budget and the environment.

- 6.2 However it is interesting to note that the position of the ACF in relation to FBT and company cars has changed over recent times. McMillan Shakespeare approached the ACF in late 2008 and provided the ACF with pivotal research and statistics about company cars including the findings contained in this submission. As a result, the ACF now have the following position⁵ that is based on the research undertaken by McMillan Shakespeare and is based on this submission.

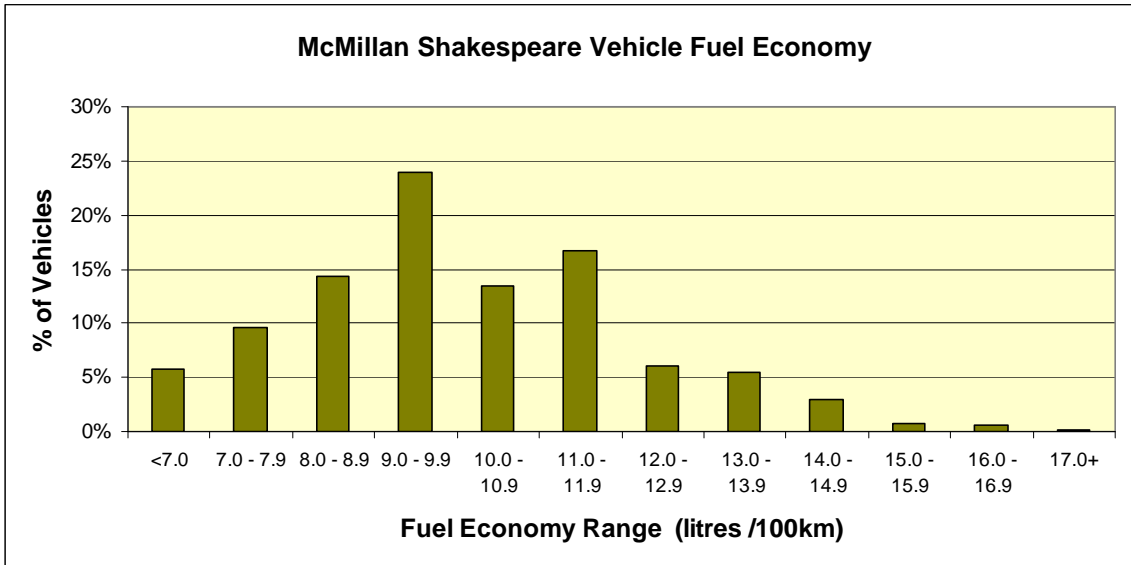
The FBT concessions for company cars should be restructured to create positive incentives for efficient vehicles, remove perverse incentives to drive more, generate revenue, and complement efforts to re-tool the Australian car industry for cleaner vehicle production (including through the Green Car Innovation Fund). The best way of achieving this would be to tie the FBT concessions to a vehicle's emissions rating (based on the Green Vehicle Guide) from 1 April 2009.

This approach has the additional benefit of being administratively less burdensome and less susceptible to manipulation than the existing formula, which requires annual self-assessment of distance driven.

- 6.3 The Government's intention is to implement the Carbon Pollution Reduction Scheme in 2010 and is committed to reducing greenhouse gas emissions.
- 6.4 Australia has set a target of a 60 per cent reduction in greenhouse gas emissions (2000 level) by 2050. Motor vehicles are a contributor to greenhouse gas emissions.
- 6.5 The average rate of fuel consumption for Australian cars is 13.8 litres per 100 km. The voluntary target by the industry is 6.8 litres per 100 km by 2010.

⁵ ACF Submission to Department of the Treasury Priorities for the Federal Budget 2009 - 10 January 2009

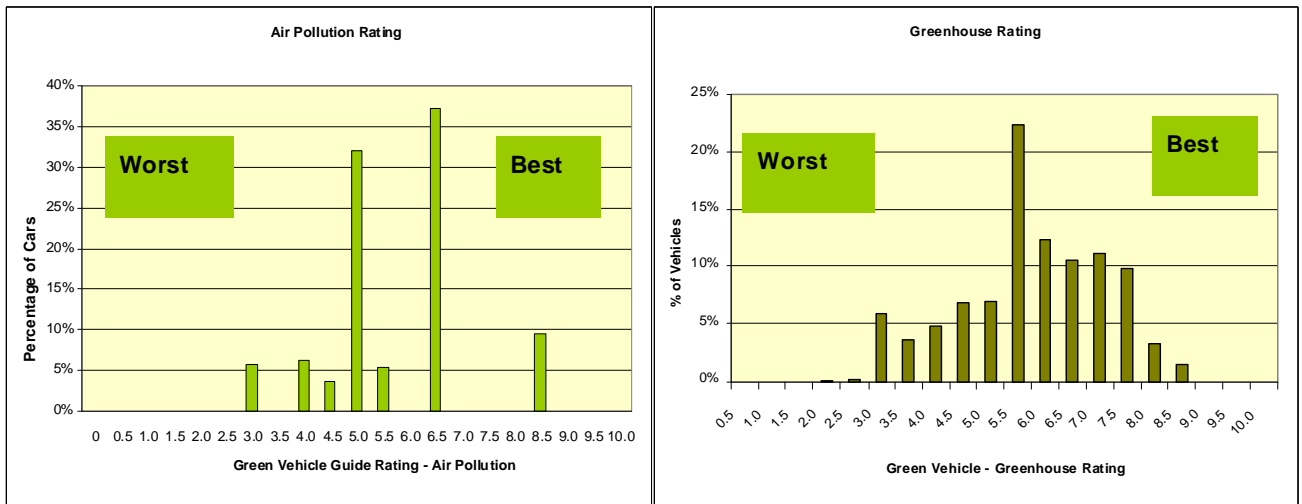
6.6 McMillan Shakespeare leased vehicles have a fuel economy which is 27% better than the Australian average.



Source: McMillan Shakespeare Client Base

6.7 The Australian Government has over recent years developed the “Green Vehicle Guide” for all new motor vehicles manufactured locally and overseas. The Overall Green Vehicle Guide (GVG) rating is based on the sum of the air pollution and greenhouse ratings. Equal weighting is given to both these ratings to arrive at a combined GVG rating (out of 20).

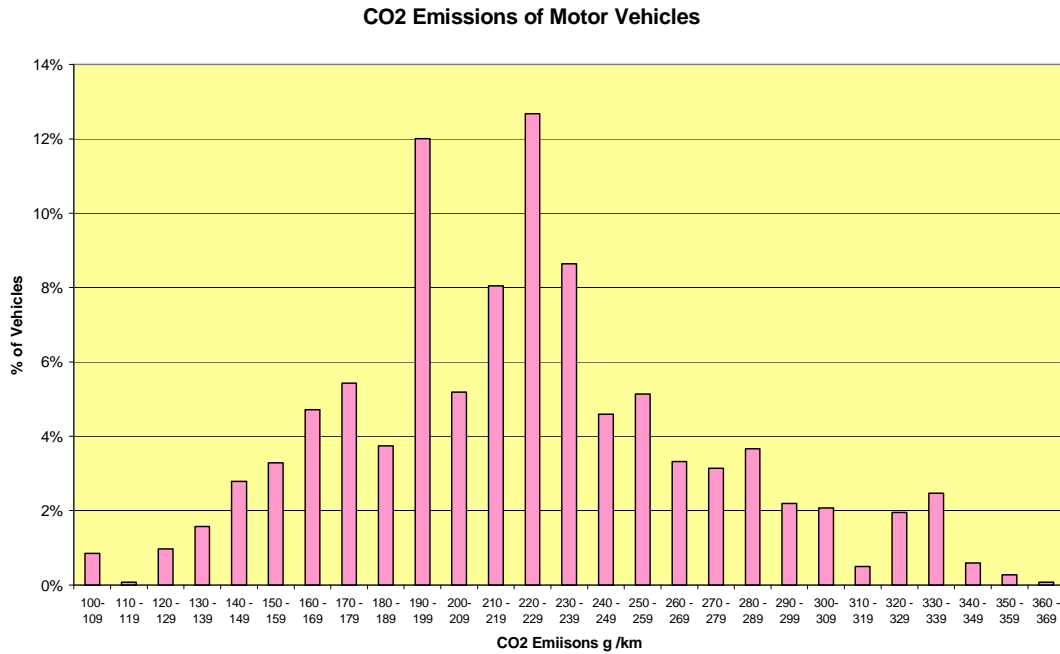
6.8 74% of McMillan Shakespeare vehicles have a Green Vehicle Guide rating of greater than 10 for air pollution and greenhouse gas emissions. (35% of the vehicles of the Commonwealth fleet have a rating of 10 or more).



Source: McMillan Shakespeare Client Base

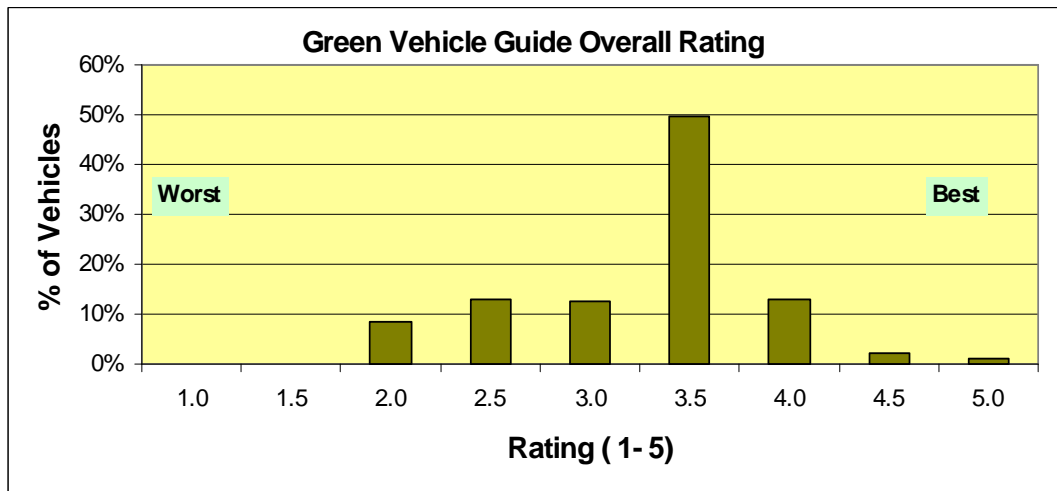
6.9 For CO₂ emissions, the average McMillan Shakespeare vehicle is rated as follows:

- Small cars – 9% less than the highest emitting vehicle in this class;
- Medium cars – 20% less than the highest emitting vehicle in this class;
- Large cars – 19% less than the highest emitting vehicle in this class.



Source: McMillan Shakespeare Client Base

6.10 The combined GVG rating (out of 20), is converted to a Star rating (1 – 5 stars). 74% of McMillan Shakespeare vehicles have Green Vehicle Guide rating of at least 3.5 stars (maximum is 5 stars).



Source: McMillan Shakespeare Client Base

6.11 Conclusion

The environmental impact of the motor vehicle is increasingly being debated and questioned by a range of interest groups. The Australian Government has set targets for carbon pollution and designed policies and incentives for the local Australian motor vehicle industry. The evidence presented illustrates that if employees are provided with motor vehicle choice, they will generally select motor vehicles that are more greenhouse friendly (smaller and more fuel efficient producing lower carbon emission). Additionally, the evidence shows that the tax benefit is an effective incentive to people to buy new cars. New cars are increasingly designed to reduce green house emissions.

At this time, there are very few makes and models of locally produced motor vehicles that are considered “environmentally friendly” for employees to choose from. The Federal Governments initiatives for “A new car plan for a green future” will produce a greater range of motor vehicle options for employees and employers over the next few years.

7 Climate Change

7.1 The Garnaut Climate Change Review was an independent study conducted by economist Professor Ross Garnaut, commissioned by Australia's Commonwealth, state and territory governments in 2007. The Final Report⁶ made the following comment in relation to the FBT applying to benefit vehicles in September 2008:

Some policies reduce the cost of vehicle use or create incentives for use. The fringe benefits tax provisions attempt to value benefits provided by employers to employees as part of salary packages in order to appropriately tax them. However, the current treatment of vehicles and parking spaces distorts decisions towards private vehicle use and greater demand of transport overall (Commonwealth of Australia 2008). These provisions could be improved by:

- *ensuring the salary sacrifice arrangements are mode neutral*
- *amending the statutory fraction method to ensure it is distance neutral.*

7.2 The Prime Minister made the following comments in a speech⁷ to announce the Governments White Paper in response to the Final Report of the Garnuat Review:

In designing the Carbon Pollution Reduction Scheme we've been mindful of the challenges facing the Australian economy today. Our primary objective has been to get the balance right, to set in place a scheme that reduces carbon pollution and supports economic growth. This means supporting Australian jobs and assisting households today while moving to the low pollution economy that will help to create the new jobs of the future.

Hundreds of thousands of jobs will be created over time as Australia makes the transition to a low pollution economy. Treasury modeling estimates that taking responsible action on climate change will see the renewable energy sector alone grow to 30 times its current size by 2050, creating new jobs for the future.

⁶ The Garnaut Climate Change Review – Final Report – page 527

⁷ National Press Club Address By Prime Minister Kevin Rudd On The Federal Government's Carbon Pollution Reduction Scheme - 15 December 2008

8 Targets for reducing Australia's carbon pollution motor vehicles

8.1 The Government has set aggressive targets in its commitment to reduce carbon emissions caused by motor vehicles. In the white paper,⁸ the following information on these targets is outlined:

The Australian Government has a substantial commitment to reduce our carbon pollution by 60 per cent of 2000 levels by 2050.

By 2020, we have committed to reduce Australia's carbon pollution by up to 15 per cent below 2000 levels in the context of a global agreement where major economies agree to substantially restrain carbon pollution and advanced economies take on reductions comparable to Australia.

We have also committed to an unconditional 5 per cent reduction in carbon pollution below 2000 levels by 2020, which represents a significant cut of around 27 per cent on a per capita basis.

By harnessing the innovation and efficiency of the market, the Carbon Pollution Reduction Scheme will allow Australia to meet these serious targets at the lowest overall cost to our economy.

The Bureau of Infrastructure, Transport and Regional Economics has estimated that, in the short term, car fuel use in Australia declines by about 1.5 per cent in response to a 10 per cent increase in the petrol price, but that this decline increases to 4 per cent when longer-term responses are taken into account.

Australia, in contrast to European countries, has not had a period of elevated fuel prices for longer than seven years (in the late 1970s and early 1980s). It is possible that the long-run responsiveness to radically higher fuel prices could be even greater, given threshold effects on consumer choices and technological development. International studies have suggested that, at higher fuel prices, consumption declines by up to 7 per cent for every 10 per cent increase in fuel prices, once demand- and supply-side (technology) changes are taken into account.⁸

Long-term reductions are the result of changes in vehicle size, vehicle fuel efficiency, vehicle fuel type, technology, mode of transport (for example, road, rail or cycling), and residential location.

- *In 2003, 30 per cent of Australian purchasers of passenger motor vehicles bought large vehicles; in 2007, 18 per cent. Consumers are also choosing more fuel-efficient vehicles within each size category. This has reduced new vehicle average fuel efficiency under standard test conditions from 9.7 L/100 km in 2003 to 9.0 L/100 km in 2007.*
- *Diesel vehicles, the most fuel-efficient conventional liquid fuel vehicles, increased their share of new vehicle sales from 5 per cent in 2005 to 9 per cent in 2007.*
- *Hybrid vehicles accounted for 0.2 per cent of sales in 2005, and 0.6 per cent in 2007.*

8.2 The McMillan Shakespeare submission has taken account of these objectives. Three of our suggested options directly link FBT to carbon emissions. We have evaluated the outcome of carbon emissions for each of our options and in the modeling undertaken by Access Economics one of our options will reduce carbon emissions for each replacement vehicle by 20% or one tonne of CO₂.

⁸ Carbon Pollution Reduction Scheme Australia's Low Pollution Future, White Paper, Volume 1 December 2008

9 Greening the Australian Motor Vehicle Industry

9.1 In February 2008, the Government appointed Mr Steve Bracks, the former Premier of Victoria to conduct of review of the Australian Motor Vehicle Industry. This Review was established prior to the taxation review.

9.2 The automotive industry is a major contributor to Australia's economy⁹:

- It employs over 64,000 people;
- In 2007, about 335,000 cars worth \$7.7 billion were produced;
- Exports of \$4.7 billion and is among Australia's top 10 export earners;
- A major investor in innovation.

9.3 The industry has important links to the rest of the economy, and supports Australia's capabilities in a range of other industries.

9.4 The Minister for Innovation, Industry, Science and Research for Senator the Hon Kim Carr reiterated the importance of the local motor vehicle industry on 22 August 2008¹⁰:

The fact is that a car industry is extremely important for Australia's economic and social wellbeing. It is a vital part of our manufacturing base. It provides the spillovers that allow us, in a whole range of other manufacturing industries, to do very well. It even provides the foundations for advances that we make in the mining industry.

You can't make a jet fighter without having a strong car industry and that's precisely what we are doing now. It means that we can actually make railway rolling stock, we can provide services to a whole range of other sectors. So it's extremely important that we maintain the capacity and once you lose it, you never get it back.

9.5 In August 2008, the Brack's Review provided government with its final report to consider and a response was provided by Government in November 2008. The Prime Minister stated in his speech¹¹:

At a time of global financial crisis the Government today takes further decisive action to support Australian industry, to support Australian jobs. Because we believe this industry has a future and a big future in Australia's economy of the 21st Century.

We take decisive action to build an internationally-competitive, green economy for the future.

Australia needs a green car industry that manufactures the fuel-efficient, low emission vehicles of the future and that creates the well-paid, highly-skilled green jobs of the future.

9 Media release Honorable Steve Bracks, 15 August 2008, "Release of Automotive Industry Review report".

10 Interview with ABC Melbourne regarding Ford Australia 22 August 2008

11 Remarks at the launch of the New Car Plan for a Greener Future Auto CRC Melbourne - 10 November 2008

We do not have to choose between having a growing economy in the short term and a green economy in the medium to long term.

We can work effectively to develop both and that's a large part of what today's package is all about.

And the automotive industry is critical to a green investment strategy for the nation.

The automotive industry is already a cornerstone of manufacturing.

What we need is innovative industry. We need a supply chain working together. We will need a supportive policy framework. We also need an automotive industry vision.

And that's why I am here today to launch a New Car Plan for a Green Future for Australia.

The automotive industry has a key role to play responding to climate change.

The industry must reduce vehicle emissions by producing smaller, lighter, and more fuel efficient vehicles that produce fewer greenhouse gas emissions.

Faced with this complicated set of industry challenges – markets, economies, and the environment – some might say it's not worth trying to have a car industry. That is not my view. It is not the view of the Australian Government and it never will be the view of any Government which I lead.

9.6 The Government's response which is detailed in the *A New Car Plan for a Greener Future*¹² provides for the following initiatives to support the vehicle industry:

- *a new, better targeted, greener assistance program, the Automotive Transformation Scheme (ATS), running from 2011 to 2020 and providing \$3.4 billion to the industry;*
- *an expanded Green Car Innovation Fund of \$1.3 billion brought forward to 2009 and running over ten years;*
- *changes to the Automotive Competitiveness and Investment Scheme in 2010 to smooth the transition to the ATS (\$79.6 million);*
- *\$116.3 million to promote structural adjustment through mergers and consolidation in the components sector (from 1 January 2009) and facilitate labour market adjustment (from 1 November 2008);*
- *\$20 million from 2009–10 to help suppliers improve their capacity to integrate into complex national and global supply chains;*
- *\$6.3 million from 2009–10 for an enhanced market access program;*
- *a new Automotive Industry Innovation Council, bringing key decision makers together to drive innovation and reform; and*

¹² A New Car Plan For A Greener Future – Department of Innovation, Industry, Science and Research – November 2008

- a \$10.5 million expansion of the LPG vehicle scheme, to start immediately, that doubles payments to purchasers of new private use vehicles that are factory-fitted with LPG technology.

9.7 The Prime Minister also stated in relation to the Global Economic Crisis and the Australian Motor Vehicle Industry that¹³:

At a time when there is a lot of global pressure on the industry, the attitude of Government can either be to wash your hands of it and say, 'not my problem', or to step in as a partner. We believe in partnership. We believe in partnership with the Australian auto industry. And we believe in that partnership for the long term future.

Part of our response to the global financial crisis and global economic crisis is to create the rational grounds for confidence in the future as well and us putting a solid step forward with this decisive action today, a \$6.2 billion investment for the future, is part of the confidence equation for the future as well.

10 Henry Review – Fringe Benefits Tax and Motor Vehicles

10.1 The Treasurer¹⁴ announced in May 2008 that it would:

..... conduct a comprehensive review of Australia's tax system to create a tax structure that positions us to deal with the demographic, social, economic and environmental challenges of the 21st century.

The review will encompass Australian Government and State taxes, except the GST, and interactions with the transfer system, and will consider:

1. *The balance of taxes on work, investment and consumption and the role for environmental taxes;*
2. *Further enhancements to the tax and transfer system facing individuals, families and retirees;*
3. *The taxation of savings, assets and investments, including the role and structure of company taxation;*
4. *The taxation of consumption and property and other state taxes;*
5. *Simplifying the tax system, including the interactions between federal, state and local government taxes; and*
6. *Interrelationships between the elements of the tax system, as well as the proposed emission trading system.*

10.2 One of the taxes under review is Fringe Benefits Tax (**FBT**). In 2006-07 the Government¹⁵ collected a total of about \$3.8 billion in FBT from 69,000 tax payers (i.e. employers).

¹³ Doorstop interview with the Minister for Innovation, Industry, Science and Research, Kim Carr Melbourne, 10 November 2008 (www.pm.gov.au/media/Interview/2008/interview_0594.cfm)

¹⁴ Treasurer's Media Release - Australia's Future Tax System – NO.O36

¹⁵ Architecture of Australia's tax and transfer system - August 2008

10.3 The following questions were raised in the Consultation paper issued by the Review in December 2008 in relation to FBT and motor vehicles:

Q4.6 How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?

Q13.1 Bearing in mind that tax is one of several possible instruments that can address environmental externalities, what opportunities exist to use specific environmental taxes to address Australia's environmental challenges?

Q13.2 Noting that many submissions raise concerns over unintended environmental consequences of taxes and transfers, such as the fringe benefits tax concession for cars, are there features of the tax-transfer system which encourage poor environmental outcomes and how might such outcomes be addressed?

Q13.3 Given the environmental challenges confronting Australian society, are there opportunities to shape tax-transfer policies which do not currently affect the environment in ways which could deliver better environmental outcomes?

10.4 McMillan Shakespeare has addressed these key questions in this response.

10.5 The issues that have been raised for the Review to consider as part of the initial consultation phase in relation to the FBT applicable to benefit cars can be summarised into two major issues:

▪ **The availability of the concession:**

- Remove the concession completely;
- Retain the existing concession in its current form;
- Retain a concession designed to help address simultaneously environmental issues and provide a critical source of demand for manufacturers of motor vehicles and upstream/downstream industries;

▪ **The taxation point:**

- Retain FBT as an employer tax;
- Move FBT from an employer tax to an employee tax.

- 10.6 McMillan Shakespeare supports the need to change the current FBT arrangements in favour of a concessional formula based on the environmental rating of the motor vehicle rather than the kilometers traveled. We have articulated and calibrated a new FBT formula in detail later in our submission.
- 10.7 Further, we strongly support the current arrangements whereby employers are responsible for the ultimate payment of FBT.
- 10.8 In terms of pure efficiencies and compliance, shifting the point of taxation from 69,000 employers who currently submit FBT returns, to circa 1 million employees, does not make practical sense. Everyday working Australians need less administration and taxation burdens not more. Additionally, from an ATO perspective collection from employers is more efficient and is likely to have a higher level of compliance.
- 10.9 Moreover employers have well developed systems and programs in place (often for more than 20 years) to easily and systematically process FBT in relation to salary packaging including motor vehicles.
- 10.10 In practical terms the employer almost always insist that employees are also required to salary sacrifice the cost of any FBT incurred to their employer. A “no cost to the employer” policy prevails wherever motor vehicles are provided.

11 Exploring the Options for FBT and Motor Vehicles

- 11.1 McMillan Shakespeare has been researching and investigating the current FBT arrangements and the other options possible since early 2008.
- 11.2 We have committed significant resources to undertake the following:
- Submitted a detailed submission to the Review as part of the first round of consultation;
 - Made available industry statistics in relation to motor vehicle benefits;
 - Attempted to engage stakeholders about the use of salary sacrifice for motor vehicles in the Australia workforce and to dispel the myths that promulgated about motor vehicle benefits;
 - Developed alternative proposals for the taxing of motor vehicle benefits;
 - Engaged in discussion of the issues with the key stakeholders throughout Australia;
 - Undertaken focus groups with various parties in relation to the issues and our proposals;
- 11.3 We have also engaged Lateral Economics and Access Economics to prepare a detailed report on the economic and environmental impact of our alternative proposals. A copy of their report is provided in Appendix 1.

11.4 We considered four options for replacing the current formula for determining the taxable value of a benefit vehicle. The options have been developed in relation to the following criteria:

- Maintaining a tax concession for benefit vehicles;
- Providing a revenue neutral outcome for government in relation to the collection of FBT;
- Continuing the support for the demand side of the Australian motor vehicle industry;
- Supporting the Government's aim of reducing greenhouse gas and CO₂ emissions; and
- Maintaining an administratively simple process for employers.

11.5 McMillan Shakespeare has identified four options that could be used to replace the existing formula (pages 33 to 48 of this report):

- **Option 1** is a modified version of the current FBT system in which there are finer gradations in the statutory rate scale;
- **Option 2** is modeled on the UK's Emissions Rating scheme, with lower emission cars (measured by their CO₂ emissions per kilometre) facing a lower rate; and
- **Option 3** incorporates aspects of both the UK CO₂ scheme and the current scheme by basing the statutory rate on total emissions; and
- **Option 4** proposes a statutory rate based on the environmental rating of the car.

12 Removal FBT Concession All Together

12.1 The relative importance of benefit vehicles is that they accounted for 21% of the new car sales in 2007 and 35% of total Australian manufacturing motor vehicles.

12.2 There have been calls for the removal of the FBT concession. As a result, we asked Access Economics and Lateral Economics to model the impacts on overall demand for benefit vehicles. (see Access Economics and Lateral Economics report Appendix 1).

12.3 Overall, the modeling shows the demand for total benefit vehicles is expected to fall by 25% if all employees made no employee contribution; to 31% (if all employees made an employee contribution). That is a reduction in production of local vehicles of up to 21,416 vehicles¹⁶ per annum.

¹⁶ Access Economics – Fringe Benefits Tax Analysis report

12.4 This would have significant effects on the Australian economy:

- It is likely there would be significant loss of jobs directly and indirectly;
- This would be devastating for the local vehicle industry at a time when the Government has announced a significant plan to support the industry;
- Many hundreds of thousands of employees with “company” benefit motor vehicle arrangements already in place would be greatly disadvantaged;
- As many of these benefits are enshrined in industrial agreements, employees and unions are likely to demand compensating salary increases at a difficult time for business;
- There would be additional workload on the ATO as employees in large numbers will claim travel reimbursements via the taxation system.

12.5 The increase in the effective vehicle price if the existing FBT arrangements were removed is summarised in the following table¹⁷;

INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT) OVER THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution	44.8	43.8	42.8	45.7	42.5	44.3	46.9
No Employee post-tax contribution	33.4	32.6	30.7	34.7	30.4	33.0	35.9

12.6 McMillan Shakespeare has estimated that in 2007 about 180,000 vehicles sales were for company (benefit) vehicles and that about 600,000 to 700,000 vehicles on the road are benefit vehicles. In 2007 about 69,000 locally made vehicles were purchased as benefit vehicles which represents approximately 40% of total purchases of benefit vehicles.

¹⁷ Access Economics – Fringe Benefits Tax Analysis report

12.7 The following table¹⁸ shows the estimated impact on benefit vehicle sales if the FBT concession were removed:

ESTIMATED IMPACT ON BENEFIT VEHICLE SALES (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	-30.5	-30.4	-31.6	-31.3	-24.9	-41.4	-31.9
Employee post-tax contribution: Local sales	-30.6	-30.3	0.0	-30.4	0.0	-55.4	-30.6
No employee post-tax contribution: Total sales	-23.2	-18.8	-27.5	-27.8	-15.9	-44.5	-26.4
No employee post-tax contribution: Local sales	-23.3	-19.3	0.0	-28.4	0.0	-53.5	-24.4

12.8 The table shows that there would be a dramatic reduction in benefit vehicle sales.

12.9 Given that 35% (69,083 out of 200,000) of locally produced vehicles are benefit vehicles, the impact on the local manufacturing industry will be greater than for imported vehicles.

¹⁸ Access Economics – Fringe Benefits Tax Analysis report

12.10 The following table¹⁹ shows the estimated impact on **total** vehicle sales if the FBT concession was removed:

ESTIMATED IMPACT ON TOTAL VEHICLE SALES (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	-11.6	-8.7	-4.3	-11.4	-2.4	-7.5	-2.7
Employee post-tax contribution: Local sales	-11.9	-8.7	0.0	-12.3	0.0	-10.2	-5.1
No Employee post-tax contribution: Total sales	-8.8	-5.4	-3.8	-10.1	-1.5	-8.1	-2.2
No Employee post-tax contribution: Local sales	-9.0	-5.5	0.0	-11.5	0.0	-9.8	-4.0

12.11 Any removal or diminution of the FBT concessions for motor vehicles will have a substantial impact on sales and is likely to significantly impact the industry's viability.

12.12 Moreover, simply removing FBT concessions for "Company Cars" does not address the issue of the environmental impact of the motor vehicle in terms of carbon emissions. In fact, we argue that fewer new cars will be replacing older cars and therefore more carbon emissions will result because new cars generally emit less carbon emissions than older cars.

12.13 The removal of FBT Concessions for benefit motor vehicles will have a substantial negative impact on the Australian Motor Vehicle Industry and likewise negatively impact on carbon emissions from motor vehicles.

13 FBT as an Employee Tax

13.1 One of the issues in relation to FBT management and compliance is the call to shift the tax source from the employer to the employee. That is, the FBT on employer provided benefits will shift from an employer liability to an employee liability. This is a specific question raised in the Henry Consultation paper. Question 4.6 "How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?"

¹⁹ Access Economics – Fringe Benefits Tax Analysis report

13.2 The arguments put forward for adopting this proposal are:

- FBT is too complex and provides an unnecessary financial and administrative burden on employers;
- Removing FBT will simplify the tax system;
- The employee is receiving the benefit therefore the employee should pay the tax;
- Australia is one of the few OECD countries with fringe benefit taxed in the hands of employers;

13.3 However there are a number of arguments that support the retention of the current regime. Employers will always provide benefits to employees and therefore there still needs to be a method of calculating the taxable value irrespective of whether the employee or the employer pays any applicable tax.

13.4 Those countries that do not have an FBT regime still have regulations and laws to tax employer provided benefits. Therefore simply removing the liability for the tax from the employer will not necessarily ensure that the taxing of benefits is simplified.

13.5 The current method of taxing benefits is the most effective and efficient. The ATO only needs to deal with about 69,000 employers who lodge FBT returns and not have to deal with circa 1 million employees. The following statement was made to the Senate Committee on Economics in June 2008 by a Treasury official:

- *One of the key reasons FBT was introduced as an employer tax was to deal with the complexity that the evaluation of benefits would cause for employees.*
- *We have competing interests here as to who owns the complexity. Applying FBT as an employer tax is, relative to applying it to the individual, a far simpler taxation system. That said, there are some complexities involved. We have 12 or 13 categories of what is a fringe benefit in the law— that is, there are 12 plus the residual of everything that is left. That is part of the balancing arrangements to ensure that remuneration in the form of income and other forms of remuneration, such as non-cash benefits, are taxed appropriately.*
- *There are competing complexities and we need to deal with those. Increasing efficiency and effectiveness within the design of the system is an unending process. However, a very simple system could lead to inequity. So you need to balance those interests, and circumstances, while at the same time looking at the bigger picture. I think they can go hand in hand.*

13.6 In any event, most employers pass on the costs of administration including FBT to participating employees. A “no cost to employer” policy prevails as most employers either outsource the administration of FBT and or have very well developed and robust administration and compliance systems for motor vehicles FBT.

13.7 The provision of car benefits by employers is a major source of (FBT) revenue to government. In addition, there are significant flow on effects to the motor vehicle industry, the economy and employment if there is a shift in the liability for the FBT to the employee. Such a move will

negatively impact on employees, employers and the industry. For example, new and additional complex burdens on “working Australians” will discourage their participation and therefore sales, there will need to be complete changes to payroll systems and the like for employers and outsourced administrators at significant cost. The sum of these costs and the added burden on employees far out-weighs any benefits. It would be change for change’s sake.

13.8 Generally, the strongest proponents of the called to “shift” FBT compliance from employer to employee is being advocated by the accounting and consulting professions. We suggest that the accounting and consulting professionals will stand to gain most from the massive dislocation and confusion that will prevail.

13.9 Taxing fringe benefits in the hands of employees rather than employers (motor vehicles and/or other fringe benefits) does not stand up to cost/benefit analysis.

Exploring the options for a new FBT regime for motor vehicles

14 Option 1 - Modification of the Existing Formula

14.1 The Bracks Review considered the following issues in relation to FBT on motor vehicles:

- *Are there ways of reducing greenhouse gas emissions through changes to Government taxation arrangements and other policies?*
- *Should Australia consider taxes and charges based on, for example, kilometers travelled and vehicle emissions? What would be the impact on the industry of such arrangements?*

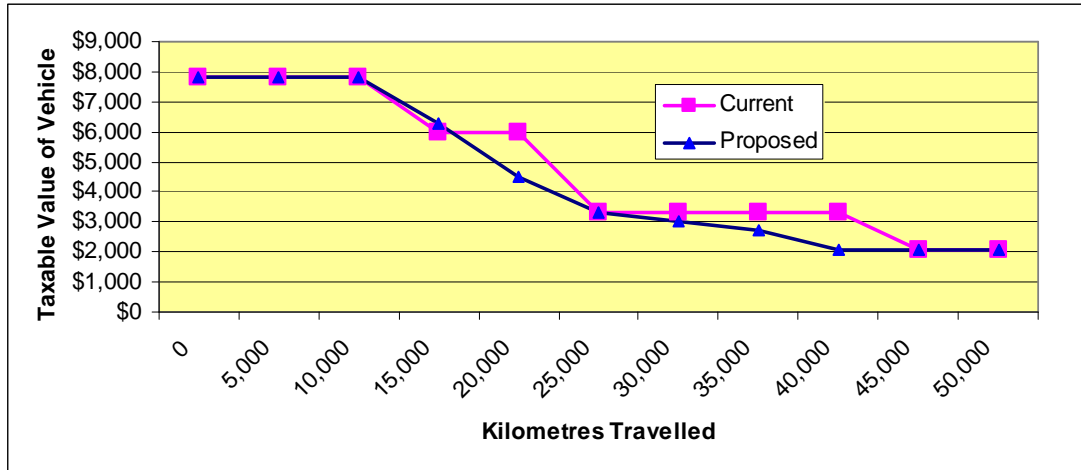
14.2 The report provided to Government by the Brack’s Review stated:

There is anecdotal evidence that current FBT arrangements encourage drivers to increase the amount of kilometers driven in order to reduce FBT liability. This is at odds with the Government’s broad environmental goals of reducing carbon emissions.

14.3 The report proposes the following new rate table for consideration:

Km range	Percentage
0 -14,000	26%
14,001 - 16,000	21%
16,001 - 18,000	19%
18,001 - 20,000	17%
20,001 - 22,000	15%
22,001 - 24,000	13%
24,001 - 26,001	11%
26,001 - 34,000	10%
34,001 - 40,000	9%
40,000 +	7%

14.4 If the percentages in the table above are applied to a vehicle with a base value of \$30,000, in most cases the taxable value of the vehicle will be less than would apply if the existing rates are used.



14.5 The graph above illustrates that the use of these statutory rates will result in a lower taxable value for many vehicles therefore reducing Government revenue. Access Economics have made an estimate of the cost of this formula as detailed in the table²⁰ below:

Year	2008-09	2009-10	2010-11	2011-12
Cost \$ million	-191	-195	-198	-193

14.6 The adoption of statutory rates provided in the Bracks report will result in a 10% reduction in FBT collection.

14.7 The recommendation made in the Bracks report stated:

The Henry Review of taxation should consider the adoption of a new statutory rate table that is more evenly spread across the range of kilometers traveled. The new rate table would encourage drivers to use their vehicles only as necessary.

14.8 The government noted this recommendation in its response²¹ and also stated:

The issue of FBT for motor vehicles will be examined by the review of Australia's Future Tax System (the Henry review).

²⁰ Access Economics – Fringe Benefits Tax Analysis report

²¹ A New Car Plan For A Greener Future

14.9 McMillan Shakespeare proposes that the following revenue neutral rate table is considered:

Km range	Statutory Rate Bracks Report	Statutory Rate
0 -14,000	26%	29.00%
14,001 - 16,000	21%	23.50%
16,001 - 18,000	19%	21.25%
18,001 - 20,000	17%	19.00%
20,001 - 22,000	15%	16.75%
22,001 - 24,000	13%	14.50%
24,001 - 26,001	11%	12.25%
26,001 - 34,000	10%	11.25%
34,001 - 40,000	9%	10.00%
40,000 +	7%	7.75%

14.10 The rates proposed by McMillan Shakespeare will provide a revenue neutral outcome and provide the "green" benefits suggest in the Bracks report.

14.11 No analysis was undertaken of the effect on either the Australian vehicle industry or the reduction in carbon emissions of this model by Access Economics.

14.12 However it would be expected that there would be a behavioural change in drivers because the incentive to drive unnecessary kilometres would be decreased, therefore reducing carbon emissions.

14.13 The option is very much a business as usual step and would not be expected to impact on motor vehicle sales.

14.14 The administration of this model does not add any complexity to the administrative requirements of employers.

14.15 This option is desirable in the short term (say 6 years) as part of the transition to a formula based on the environmental rating of the vehicle.

15 Option 2 - Emissions Rating of the Vehicle

15.1 This model is an environmentally based model which takes account of the CO₂ emissions of the vehicle.

15.2 McMillan Shakespeare is proposing the following option for consideration for determining the taxable value of a benefit vehicle.

$$\text{Taxable Value} = (A \times B \times C)/D - E$$

Where:

A = the base value of the car

B = the statutory percentage (based on carbon emissions of vehicle)

C = the number of days in the FBT year when the car was used or available for private use of employees

D = the number of days in the FBT year

E = the employee contribution

Motor vehicle CO ₂ Emissions (g/km)	Statutory Rate Revenue Neutral
< 140	3.00%
145	3.75%
150	4.50%
155	5.25%
160	6.00%
165	6.75%
170	7.50%
175	8.25%
180	9.00%
185	9.75%
190	10.50%
195	11.25%
200	12.00%
205	12.75%
210	13.50%
215	14.25%
220	15.00%
225	15.75%
230	16.50%
235	17.25%
> 235	18.00%

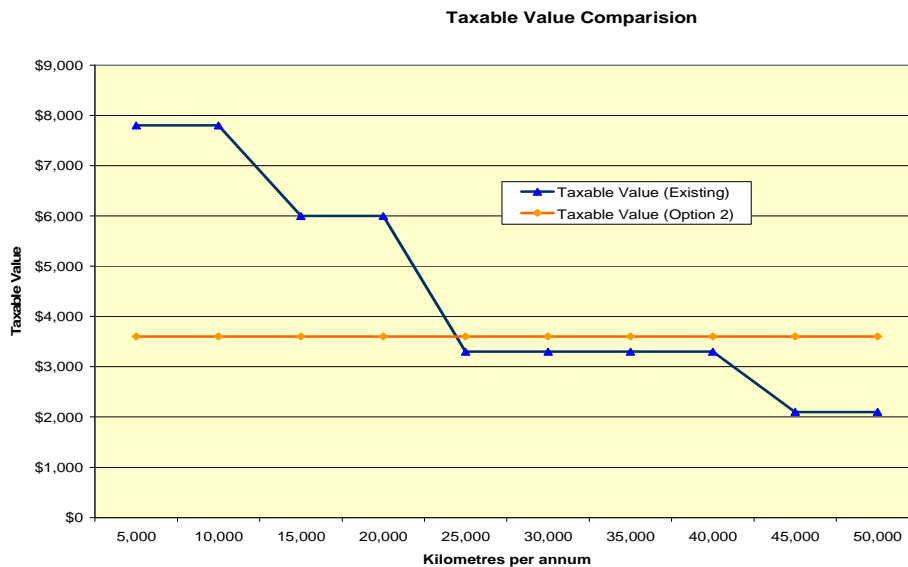
15.3 The statutory fractions that are proposed have been calculated by Access Economics to provide a tax revenue neutral FBT outcome and are based on the dataset of vehicles provided to Access Economics by McMillan Shakespeare.

15.4 The Government's Green Vehicle Guide is the source of the CO₂ emissions rating for each vehicle used in the dataset provided to Access Economics by McMillan Shakespeare.

- 15.5 The major difference between this model and the existing scheme is that vehicles which have low CO₂ emissions pay less FBT. This is intended to provide an incentive to employers and employees to select vehicles with low emissions.
- 15.6 This model is not linked to the number of kilometres driven.
- 15.7 This model has been used in the United Kingdom since 2002. A major difference is that any fuel used by the vehicle is also subject to FBT in the United Kingdom.
- 15.8 The inclusion of fuel in the FBT calculation would add to the complexity and work load of employers. In addition employees and employers in remote areas would suffer an additional penalty through higher fuel prices. Geographical distances and other related demographic and workplace factors distinguish the United Kingdom from Australia.
- 15.9 The following example illustrates how this model could operate for example:

A vehicle with a Base Value of \$30,000 would have a taxable value of \$3,600 ($\$30,000 \times 12.5\% = \$3,600$) irrespective of the number of kilometers travelled by the vehicle where the vehicle was available for a full FBT year.

The following chart shows a comparison with the existing taxable value for a range of kilometers.



- 15.10 Access Economics were not requested to provide data on the impact of this model on the vehicle industry and the effect on carbon emissions.

15.11 This option is not recommended because there are more than 20 statutory percentage and CO₂ emission levels with gradual increases. This option is not expected to result in any demonstrable behavioural shift in the choice of “greener” motor vehicles and is less likely than option 4 to be easily recognised and understood.

16 Option 3 - Actual Tonnes of CO₂ Emitted

16.1 The model is also an environmentally based model which takes account of the actual CO₂ emissions of the vehicle. It therefore requires the employer to collect the actual kilometres traveled by the vehicle during the FBT year as is currently the case.

16.2 For example if the vehicle has a CO₂ rating of 150g/km and the vehicle travels 10,000 kilometres, then the vehicle has emitted 1.5 tonnes of CO₂.

16.3 McMillan Shakespeare is proposing the following option for consideration for determining the taxable value of a benefit vehicle.

$$\text{Taxable Value} = (A \times B \times C)/D - E$$

Where:

A = the base value of the car

B = the statutory percentage (based on the tonnes of CO₂ emitted)

C = the number of days in the FBT year when the car was used or available for private use of employees

D = the number of days in the FBT year

E = the employee contribution

Motor vehicle Tonnes of CO₂	Statutory Rate Revenue Neutral
1	5.00%
2	6.25%
3	7.25%
4	14.50%
5	18.00%
6	21.75%
7	23.50%
8	25.25%
9	27.00%
10	29.00%

16.4 The following table prepared by Access Economics²² illustrates the percentage change in the effective price of a vehicle as a result of the adoption of the statutory rates listed in the table above.

INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	0.2	-3.1	-3.7	1.3	-2.4	-7.0	3.5
Employee post-tax contribution: Local sales	0.0	-4.3	0.0	9.3	0.0	-7.0	2.6
No Employee post-tax contribution: Total sales	1.4	-4.0	-5.0	2.2	-3.9	-9.6	5.8
No Employee post-tax contribution: Local sales	0.9	-5.2	0.0	14.6	0.0	-9.6	4.3

16.5 The model is designed to reward cars with low emissions.

16.6 Access Economics have estimated that the overall, demand for **total benefit vehicles** is expected to rise by 0.4% and 0.6%. The impact on different vehicle types varies greatly with SUV, light/people-mover and commercial sales expected to decrease, while large, medium, small, and upper-large/sport sales expected to increase.

16.7 Demand for all locally produced “benefit” vehicle is estimated to rise by 1.2 to 2.2% depending upon the assumed employee contribution.

16.8 The impact on the total vehicle market sales is minuscule at 0.1%.

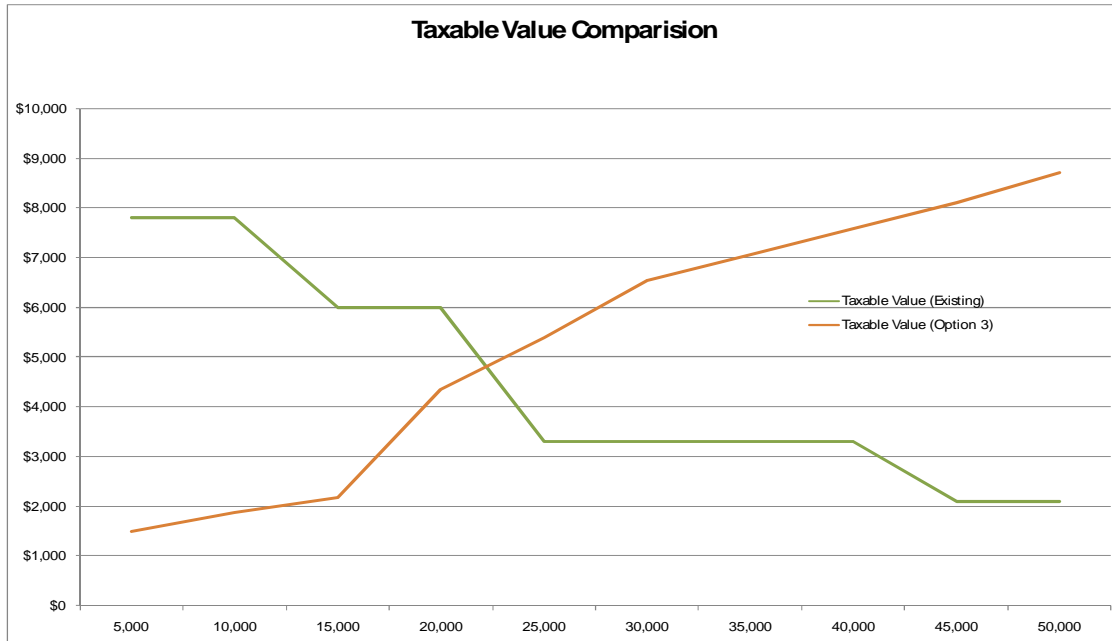
16.9 Access Economics have also estimated that option 3 will produce **NO** overall positive reduction in carbon emissions per vehicle because the price impact on new motor vehicles is not significant enough to change buying behaviour towards greener motor vehicles.

16.10 Example Assumptions.

A vehicle with a Base Value of \$30,000 with a CO₂ rating of 200 g/km which traveled 20,000 km would emit 4.0 tonnes of CO₂. This car would have a taxable value of \$2,175 (\$30,000 x 7.25% = \$2,175) where the vehicle was available for a full FBT year.

²² Access Economics – Fringe Benefits Tax Analysis report

The following chart shows a comparison with the existing taxable value for a range of kilometers versus the Option 3 model.



16.11 This option is not recommended because it does not reduce overall carbon emissions and does not reduce the overall “compliance” and administrative burden on employers and employees.

17 Option 4 - Star Rating

17.1 It is proposed to replace the existing formula with a system based on the environmental rating of the vehicle using the government’s Green Vehicle Guide (**GVG**).

17.2 The GVG provides the following information in relation to the determination of the Star Rating for each vehicle:

The Overall Rating is based on the sum of the air pollution and greenhouse ratings. Equal weighting is given to both these ratings to arrive at a combined GVG rating (out of 20), which then is translated into the star rating (as shown in the table below).

Overall Rating	Combined Air Pollution & Greenhouse Score
★★★★★	combined score >= 16
★★★★☆	15 <= combined score < 16
★★★★	14 <= combined score < 15
★★★☆☆	11.5 <= combined score < 14
★★★	9.5 <= combined score < 11.5

Overall Rating	Combined Air Pollution & Greenhouse Score
☆☆☆	8 <= combined score < 9.5
☆☆	6.5 <= combined score < 8
☆☆	5 <= combined score < 6.5
☆	combined < 5

The **Air Pollution Rating** is based on the level of air pollutant emissions allowable under the standard to which the particular vehicle has been successfully tested to for supply to the Australian market.

The main greenhouse gas emitted by motor vehicles is carbon dioxide (CO₂). The level of CO₂ emissions is linked to the amount of fuel consumed by the vehicle, and the type of fuel used. All new vehicle models up to 3.5 tonnes gross vehicle mass sold in Australia are tested to determine both the fuel consumption and the level of CO₂ emissions. This information is displayed on a Fuel Consumption Label attached to the windscreen of new vehicles.

17.3 The GVC list the following vehicles with the best star ratings:

Vehicle	Rating
smart fortwo	☆☆☆☆☆
Toyota Prius	☆☆☆☆☆
Fiat 500	☆☆☆☆☆
Fiat Punto	☆☆☆☆☆
Toyota Yaris	☆☆☆☆☆
Citroen C3	☆☆☆☆☆
Fiat Ritmo	☆☆☆☆☆
Audi A3	☆☆☆☆☆
Honda Civic	☆☆☆☆☆
Peugeot 207	☆☆☆☆☆
Audi A4	☆☆☆☆☆
Hyundai i30	☆☆☆☆☆
Toyota Corolla	☆☆☆☆☆
Mercedes-Benz A200	☆☆☆☆☆
Mercedes-Benz B200	☆☆☆☆☆
Honda Civic Hybrid	☆☆☆☆☆
Lotus Elise	☆☆☆☆☆
Mercedes-Benz C200K	☆☆☆☆☆

Vehicle	Rating
Kia Cerato	★★★★☆
Lexus GS450H	★★★★☆

The top selling vehicles have the following ratings:

Type	Vehicle	Overall Rating	Green-house Rating (10=Best)	Air Pollution Rating (10=Best)	Fuel Cons (L/100 km)
Large	Holden Commodore	★★★★	5	5	10.8
Large	Ford Falcon	★★★★	5	5	10.1
Large	Toyota Camry	★★★★☆	6	8.5	8.9
Large	Toyota Aurion	★★★★☆	5.5	8.5	9.9
Large	Mazda 6	★★★★☆	6.5	6.5	8.4
Large	Honda Accord	★★★★☆	5.5	8.5	10
Large	Subaru Liberty	★★★★☆	6	6.5	9
Large	Mercedes-Benz C Class	★★★★☆	5.5	8.5	9.6
Large	Mitsubishi 380	★★★★	5	5	10.8
Large	Honda Accord Euro	★★★★☆	6	6.5	9.1
Medium	Toyota Corolla	★★★★☆	7	8.5	7.3
Medium	Mazda 3	★★★★☆	6.5	5	8.2
Medium	Honda Civic	★★★★☆	7	8.5	6.9
Medium	Mitsubishi Lancer	★★★★	6	5	8.8
Medium	Ford Focus	★★★★☆	7	6.5	7.1
Medium	Volkswagen Golf	★★★★☆	7	6.5	7.5
Medium	Subaru Impreza	★★★★☆	6	6.5	8.8
Medium	Kia Rio	★★★★☆	7.5	5	6.7
Medium	Hyundai i30	★★★★☆	7	5	7.2
Medium	Holden Viva	★★★★☆	7	6.5	7.4
Small	Toyota Yaris	★★★★☆	7.5	6.5	6
Small	Hyundai Getz	★★★★☆	7.5	5	6.1
Small	Holden Astra	★★★★☆	7	6.5	7.2
Small	Mazda 2	★★★★☆	7.5	5	6.4
Small	Suzuki Swift	★★★★☆	7	5	6.3

Type	Vehicle	Overall Rating	Green-house Rating (10=Best)	Air Pollution Rating (10=Best)	Fuel Cons (L/100 km)
Small	Holden Barina	★★★★☆	7	6.5	6.9
Small	Kia Rio	★★★★☆	7.5	5	6.7
Small	Hyundai i30	★★★★☆	7	5	7.2
Small	Honda Jazz	★★★★☆	8	5	5.7
Small	Nissan Tiida	★★★★☆	6.5	5	7.6

17.4 McMillan Shakespeare is proposing the following option for consideration for determining the taxable value of a benefit vehicle.

$$\text{Taxable Value} = (A \times B \times C) / D - E$$

Where:

A = the base value of the car

B = the statutory percentage **(based on the car's environmental rating)**

C = the number of days in the FBT year when the car was used or available for private use of employees

D = the number of days in the FBT year

E = the employee contribution

Rating	Green Vehicle Guide Rating	Statutory Rate Revenue Neutral
Green	4 -5 Stars	6.25%
Amber	3.5 Stars	10.00%
Grey	3 Stars	18.25%
Black	Less than 3 Stars	23.50%

17.5 The following example illustrates the point strongly that the FBT option 4 will reward and incentivise employees and employers for selecting new motor vehicles that have a higher star rating.

Vehicle	Star Rating	Value (RRP)	Current Taxable Value	New Taxable Value	% Change
Prius 5D Hatchback	5	\$37,400	\$7,480	\$2,338	-69%
Toyota Landcruiser Prado GX 4WD Wagon - Petrol	2.5	\$46,670	\$9,334	\$10,967	18%

Current Taxable Value based on each vehicle travelling 20,000 km pa. Calculations based on McMillan Shakespeare Fleet.

17.6 The statutory fractions that are proposed have been calculated by Access Economics to provide a revenue neutral FBT outcome and are based on the dataset of vehicles provided to Access Economics by McMillan Shakespeare.

- 17.7 The GVG²³ is the source of the vehicle rating.
- 17.8 This formula is simple for employers to administer as the information required to determine the Star Rating is readily available and could be easily displayed on the vehicle's registration label. It also provides the ATO with a simple audit tool because the information required for each vehicle is linked to the vehicle's registration. This is not the case with the collection of odometer readings, therefore ATO compliance would improve significantly.
- 17.9 This use of this type of formula reinforces the Government's desire to reduce vehicle emissions by directly linking the emissions of the vehicle to FBT. At the same time, it underpins the government's commitment to *A New Car Plan For A Greener Future* and a viable, sustainable car manufacturing industry
- 17.10 All new cars in Australia have a star rating. "Company cars" without a star rating (older than 3 years) can be managed by providing employers with sufficient notice prior to implementation. A medium term transition will manage such issues easily and efficiently (see section 20.3 relating to transition).
- 17.11 The basic premise of this model is that vehicles with low emissions have a lower taxable value than those with higher emissions. This model will "shift" both employer and employee buying behaviour in favour of selecting greener motor vehicles as "company cars". It will also provide a source of demand that compliments the incentives the Government is providing on the supply side.
- 17.12 The proposed environmental based formula retains a tax concession for company cars. This new environmental based formula will continue to enable the Government to support the vehicle industry but with a focus on better environmental outcomes. That is, the tax concession is specifically designed to reward "greener" company cars (3 to 3.5 stars and above) and penalise "black" company cars (less than 3 stars). It also supports business by providing an additional incentive to purchase and lease vehicles which reduce emissions.
- 17.13 This option is easily understood by drivers and companies without radical change and is similar to other consumer purchases with environmental ratings such as washing machines, fridges and other household appliances. It can also be easily changed in the future to support the Government's environmental objectives.

²³ www.greenvehicleguide.gov.au

17.14 The Access Economics report²⁴ provides the following data on the effective vehicle price increase:

INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	2.4	-3.2	-4.0	1.3	-2.5	-6.2	6.4
Employee post-tax contribution: Local sales	2.4	-4.1	0.0	9.7	0.0	-6.2	4.1
No Employee post-tax contribution: Total sales	3.8	-4.0	-5.6	1.8	-3.9	-8.5	10.0
No Employee post-tax contribution: Local sales	3.9	-5.4	0.0	14.7	0.0	-8.5	7.9

17.15 The model provides a price decrease for small cars and an increase for large vehicles which reflects the star rating of the vehicle in most cases.

17.16 The impact in motor vehicle sales (benefit vehicles) is provided in the following table:

ESTIMATED IMPACT ON BENEFIT VEHICLE SALES (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	-5.4	-11.5	14.0	3.1	-11.0	38.1	-6.0
Employee post-tax contribution: Local sales	-5.4	-10.4	0.0	14.5	0.0	28.3	-4.0
No employee post-tax contribution: Total sales	-8.9	-13.6	18.6	4.9	-15.0	48.2	-9.1
No employee post-tax contribution: Local sales	-8.9	-12.2	0.0	22.4	0.0	36.1	-7.3

²⁴ Access Economics – Fringe Benefits Tax Analysis report

- 17.17 The modeling by Access Economics predicts a reduction in vehicle demand of 0.04%. This is to be expected based on the types of vehicles that are currently available i.e. there is not a lot of choice in the 'green' vehicle market.
- 17.18 Overall benefit vehicles account for around 35% of locally produced sales, so the estimated impact on total local demand is somewhat higher, with the estimated decrease ranging from 1.1% (employee contribution) to 1.7% (no employee contribution). Again, this increase largely reflects the impact on local large vehicle demand.
- 17.19 Since option 4 is mostly neutral with regard to the impact on numbers of vehicles sold another measure of the effectiveness of the option 4 is the reduction of emissions.
- 17.20 Additionally, the possible negative impact on sales can be dealt with by transition arrangements (discussed in Part 20 on page 50).
- 17.21 The average reduction in emissions per vehicle affected by the option 4 is between 17 and 20 percent per vehicle per annum. This reflects the relative efficiency of the vehicles purchased under the old scheme versus the new scheme i.e. the new cars are more carbon friendly than the cars that they are replacing.
- 17.22 It should be noted that less efficient vehicles emit roughly 5 tonnes per year while more efficient vehicles emit roughly 4 tonnes per year. Therefore each new car which replaces an old car will provide about a 20% saving in carbon emissions per vehicle or approximately 1 tonne of CO₂ per replacement vehicle. Therefore both immediately and over the longer term there will be a positive outcome on the environment in terms of a reduction in carbon emissions. Furthermore, if additional unnecessary kilometres are being travelled by employees under the current FBT regime, we would expect this practice to cease under Option 4. Therefore, even further reduction in carbon emissions would prevail.
- 17.23 The ACF in their 2009-10 Budget submission²⁵ have also submitted that the existing formula should be replaced with the following:

Green Vehicle Guide Rating	Statutory Fraction*
4 -5 Stars	7.5%
3.5 Stars	12.0%
3 Stars	20.0%
Less than 3 Stars	24.0%

- 17.24 The submission states:

The FBT concessions for company cars should be restructured to create positive incentives for efficient vehicles, remove perverse incentives to drive more, generate revenue, and complement efforts to re-tool the Australian car industry for cleaner vehicle production (including through the Green Car Innovation Fund).

Economic modelling by Access Economics and Lateral Economics commissioned by McMillan Shakespeare indicates that the above revised formula for company cars would result in a net positive impact on government revenue of \$186 million annually.

²⁵ ACF submission to Department of the Treasury Priorities for the Federal Budget 2009-10 January 2009

17.25 In the ACF model there is an increase in FBT revenue. Likewise, there will be a substantial reduction in carbon emissions (-20% or -1 tonne per motor vehicle). Each new company car that comes into the system that replaces an older private vehicle or older company car which is more likely to have higher emissions that will further add to the reduction in vehicle CO₂ emissions.

17.26 The advantages and disadvantages of this option are summarised in the following table:

Stakeholder	Advantages
Employer	<ul style="list-style-type: none"> ▪ Tax concessions (lower costs). ▪ Simple administration. ▪ Recruitment and retention tool. ▪ Able to reduce carbon emissions.
Employees	<ul style="list-style-type: none"> ▪ Tax concession (lower costs). ▪ Remuneration benefits. ▪ Choice of motor vehicle. ▪ Making a contribution to reducing carbon emissions
ATO	<ul style="list-style-type: none"> ▪ Simple administration. ▪ High level of compliance.
Motor Vehicle Industry	<ul style="list-style-type: none"> ▪ Increased sales for greener vehicles ▪ Supports the Green Car Plan ▪ Jobs. ▪ Industry viability.
Environmentalists	<ul style="list-style-type: none"> ▪ More new vehicles are on the road replacing older vehicles which are likely to have lower emissions. ▪ “Encouragement” to drive extra kilometres by employees is eliminated.

17.27 Option 4 is highly recommended as the new basis for calculating FBT for motor vehicles. This option balances support for the Australian motor vehicle industry on the one hand, and positively impacts the environment on the other. It changes the existing FBT regime into a model based on positive environmental impacts rather than tax concessions for the most kilometres driven.

18 The United Kingdom Experience

18.1 From April 2002 the tax on company cars was changed from a statutory formula similar to the current Australian to a formula based on the CO₂ emissions of the vehicle.

18.2 It was estimated in 2001 that Companies purchased approximately 50 per cent of new cars in the UK and about 20 per cent of all vehicle miles are made in company cars. That is a major producer of CO₂ emissions

18.3 The Government has published two reports on the effectiveness of this change in 2004 and 2006.

18.4 The 2004 report²⁶ states that:

As this report shows, the change to company car tax is a significant factor in this. The reform has clearly changed the way businesses think about car fleet policies and changed the behaviour of those choosing company cars, be they the fleet manager or company car driver. Car manufacturers have greater incentives than ever to produce greener, more fuel-efficient cars, and CO₂ emissions data is now commonplace on car advertisements.

In 2003 alone the reform has saved around 0.15 to 0.2 million tones of carbon, equivalent to around 0.5% of the CO₂ emissions from all road transport. Early indications from the evaluation of the company car tax reform suggest that we are on course to meet the originally anticipated reductions CO₂ emissions of between 0.5 and 1 million tones of carbon per year in the long-run. This is a significant contribution to our target to reduce CO₂ emissions by 20 per cent by 2010. The reform has also eliminated the incentive for company car drivers to drive unnecessary extra business miles for tax purposes, reducing business travel by an estimated 300 – 400 million miles last year, helping to reduce congestion.

The Government recognises that company cars are very important to businesses in the UK and to the economy as a whole. We will continue to monitor and evaluate the company car tax regime to ensure that the charge is appropriate, and achieving our goal in driving down harmful emissions and pollutants.

18.5 The results in 2006²⁷ are as follows:

- *The company car tax reform is leading to significant reductions in CO₂ emissions from cars.*
- *The results suggest that the company car tax reform is encouraging substantial numbers of people to choose cars with lower CO₂ emissions figures.*
- *The survey results suggest that around 60% of company car drivers who were given a choice of company car by their employers were influenced by the company car tax reform and as a result chose cars with lower CO₂ emissions figures.*
- *The number of company cars has reduced to around 1.2 million in 2005 compared with around 1.6 million in 2001. (The estimate in the first published evaluation report was that there would be around 1.35 million company cars at the end of 2003.) The company car tax reform is a major reason for this.*
- *The company car tax reform is leading to significant reductions in CO₂ emissions from cars. This was around 0.2 - 0.3 MtC for 2005 and may increase to around 0.35 - 0.65 MtC for 2010 and reach a maximum level of savings in the long run of around 0.4 - 0.9 MtC per year towards the end of the next decade.*
- *The results suggest that the company car tax reform is encouraging substantial numbers of people to choose cars with lower CO₂ emissions figures. Average CO₂ emissions figures from company cars were around 15g/km lower in 2004 than would have been the case if the reforms*

²⁶ Report on the Evaluation of the Company Car Tax Reform, Inland Revenue, April 2004

²⁷ Report on the Evaluation of the Company Car Tax Reform: Stage 2 Her Majesty's Revenue & Customs 22 March 2006

had not taken place. This estimate refers to the impact of the company car tax reform over and above the general reduction in CO₂ emissions from cars over recent years.

- *The survey results suggest that around 60% of company car drivers who were given a choice of company car by their employers were influenced by the company car tax reform and as a result chose cars with lower CO₂ emissions figures.*

18.6 The UK method for taxing company cars provides valuable insights into the effects of replacing the taxing of company cars with an environmental basis rather than kilometers travelled. These reports provide guidance for the McMillan Shakespeare models that are based on the carbon emissions of the vehicle. The UK experience strongly supports and establishes clear precedent for the McMillan Shakespeare Option 4 preference.

19 Recommendations

19.1 McMillan Shakespeare Limited recommends the following in relation to the application of FBT to motor vehicle benefits:

- FBT remains an employer tax;
- An FBT concession remains in place for benefit vehicles;
- The following statutory percentages are adopted from 1 April 2010 for calculating the taxable value of a benefit vehicle:

Km Range	Statutory Rate
0 -14,000	29.00%
14,001 - 16,000	23.50%
16,001 - 18,000	21.25%
18,001 - 20,000	19.00%
20,001 - 22,000	16.75%
22,001 - 24,000	14.50%
24,001 - 26,001	12.25%
26,001 - 34,000	11.25%
34,001 - 40,000	10.00%
40,000 +	7.75%

- The following statutory percentages are adopted from 1 April 2016 for calculating the taxable value of a benefit vehicle:

Rating	Green Vehicle Guide Rating	Statutory Rate
Green	4 -5 Stars	6.25%
Amber	3.5 Stars	10.00%
Grey	3 Stars	18.25%
Black	Less than 3 Stars	23.50%

19.2 McMillan Shakespeare believes that our recommendation meets the following criteria:

- Support for the maintenance of a local vehicle manufacturing industry in both the short and long term;
- Provides sufficient lead in time to enable the employers, employees and industry to adjust;
- Enables an immediate impact in relation to the reduction of carbon emissions by company cars;
- No additional workload for employers and employees and is easily understood;
- Provides a solution for reducing carbon emissions consistent with the Government's objectives;
- Is a cost neutral outcome for government;
- Provides incentives for employers and employees to reduce their carbon emissions;
- Retains the FBT concession for motor vehicles and therefore viable sales levels to support the motor vehicle industry;
- Complements the support for the Government's new car plan;
- Enables the local manufacturing industry sufficient lead in time to support customer demand;
- Supports the community's expectation to encourage greener cars;

20 Implementation and Transition Arrangements

20.1 The success of the recommendation provided by McMillan Shakespeare is dependent on a successful implementation strategy.

20.2 The major change does not occur until 1 April 2016 which enables all stakeholders sufficient time to be consulted about the implementation and to make whatever adjustments are necessary.

20.3 The following Transition Rules are proposed:

- From 1 April 2010, implement the Bracks review proposed statutory formula for calculating FBT for motor vehicles as a temporary transition measure.
- From 1 April 2016, the taxable value of all car benefits will be determined in accordance with the new star rating where the vehicle is leased or purchased on or after 1 April 2016 (option 4 star rating). (The announcement of this change, should be made at the sametime as the announcement about the change to the current statutory formula being replaced by the Bracks review formula).
- If the vehicle is leased or purchased between 1 April 2012 and 31 March 2016 , then the employer can elect to use either of the formulas to determine the taxable value of the vehicle subject to the following conditions:
 - The election cannot be changed;
 - If the vehicle is released after 1 April 2016 then the star formula must be used;
- If the vehicle is leased or purchased prior to 1 April 2012 then the star rating must be used from 1 April 2016;
- From 1 April 2020 all vehicles must use the star method irrespective of purchase date.

The objectives of the Transition Rules are to:

- Provide sufficient time to all stakeholders to transition to the new arrangements with minimal disruption;
- Enable the local car industry to meet the requirements and to minimize the impact on the sales of locally produced vehicles;
- Simplify the transition arrangements;
- Minimize any disruption to business, the workforce through the transition to the new formula;
- Maximise the opportunity to reduce CO₂ emissions;

21 What does the Future Look Like

21.1 McMillan Shakespeare anticipates that by 2014 all vehicles will have one star above their current 2008 rating. McMillan Shakespeare requested that Access Economics model the impact of this change. Based on sample estimates this implies a roughly 20% reduction in average CO₂ emissions.

21.2 The impact in the effective vehicle price is illustrated in the table below which shows a uniform decrease in the effective vehicle price:

INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT) THREE YEARS

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	-6.8	-6.6	-6.3	-5.0	-5.9	-11.7	-3.3
Employee post-tax contribution: Local sales	-6.9	-6.5	0.0	-2.2	0.0	-11.7	-3.3
No Employee post-tax contribution: Total sales	-9.5	-8.8	-9.2	-7.3	-8.9	-16.0	-5.0
No Employee post-tax contribution: Local sales	-9.6	-8.8	0.0	-3.2	0.0	-16.0	-5.0

21.3 Access Economics also reported that given the variation in effective prices changes, there will be relatively large changes in market shares of the different types of benefits vehicles.

21.4 Overall, the demand for total benefit vehicles is expected to rise by between 6.1% and 9.1%. The table below shows that large, medium and upper/large sales are expected to increase significantly, while small, SUV and commercial sales are expected to rise modestly.

21.5 In addition the demand for all locally produced benefits vehicles is estimated to rise by 9.5% (employee contribution) to 12.5% (no employee contribution). This reflects the strong growth in large vehicle sales because these vehicles will have a better tax concession than previously.

ESTIMATED IMPACT ON BENEFIT VEHICLE SALES (PERCENT)

FBT Arrangement	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial
Employee post-tax contribution: Total sales	10.4	13.1	2.5	2.5	-7.7	53.0	3.4
Employee post-tax contribution: Local sales	10.4	12.3	0.0	0.0	0.0	40.7	3.4
No employee post-tax contribution: Total sales	13.7	15.8	5.8	5.1	-4.6	60.7	5.2
No employee post-tax contribution: Local sales	13.8	15.1	0.0	1.0	0.0	47.8	5.2

With total benefit sales estimated to be roughly 21% of total vehicle sales, the aggregate demand for vehicles is expected to rise by 1.3% to 1.9% with local sales rising by 3.9 to 5.2%.

21.6 There is also expected to be a percentage reduction in emissions despite the significant increase in benefit sales. **Total emissions for benefit vehicles are expected to fall by 12.8 to 15.1%.**

21.7 The replacement of older company cars with newer company cars which are more environmentally friendly and the "growth" in company cars replacing older private cars will produce even greater reductions in emissions.

21.8 It should be noted, that all of the calculations undertaken by Access Economics provide a "snapshot" in time. We would expect further reductions in carbon emissions from motor vehicles as a result of any change in driver behaviour not driving "unnecessary kilometres" to achieve lower FBT costs. (So called March madness).

22 Meeting with Review Panel

22.1 McMillan Shakespeare would welcome the opportunity to present to some or all of the members of the Review panel to add further detail to this submission and to provide further insight on the “benefit” motor vehicle industry.

23 Further Information

For further information on this submission please contact either:

- Anthony Podesta, Executive Director on 03 9635 0100 or anthony.podesta@mcms.com.au
- Michael Kay, Managing Director and Chief Executive Officer on 03 9900 5678 or michael.kay@mcms.com.au.

24 About McMillan Shakespeare Limited

McMillan Shakespeare Limited is a public listed company on the Australian Stock Exchange (ASX Code MMS). We provide remuneration services to approximately 1,000 employers throughout Australia, including administration services for salary packaging on behalf of employers to about 200,000 employees and novated motor vehicle leasing services for about 30,000 novated motor vehicle leases.

Our clients include federal and state government departments and agencies, statutory authorities, local government, Public Benevolent Institutions, public and not-for profit hospitals, independent schools and private sector companies.

Appendix 1

Fringe benefits Tax Analysis a Report for McMillan Shakespeare Limited by Access Economics Pty Limited

Commercial-in-Confidence



16 March 2009

Fringe Benefit Tax Analysis

Report by Access Economics Pty Limited
and Lateral Economics for

McMillan Shakespeare Limited

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EXECUTIVE SUMMARY

Access Economics and Lateral Economics were commissioned by McMillan Shakespeare (MCMS) to prepare estimates of both the revenue impact and auto demand effects of alternative Fringe Benefit Tax (FBT) schemes proposed by MCMS.

Access Economics and Lateral Economics have not offered an opinion on the efficacy of the MCMS-proposed policies in this report. Therefore this report should not be interpreted as advocating or opposing the options proposed by MCMS.

MCMS has identified four options that could be used to replace the existing FBT formula:

- ❑ **Option 1** is a modified version of the current FBT system, with a greater number of gradations in the statutory rate scale.
- ❑ **Option 2** is modelled on the United Kingdom's Emissions Rating scheme, with lower emission vehicles (measured by their CO₂ emissions per kilometre) subject to a lower rate.
- ❑ **Option 3** incorporates aspects of both the UK CO₂ scheme and the current FBT scheme by basing the statutory rate on total emissions, with the rate schedule rising as vehicle mileage (and CO₂ emissions) increases.
- ❑ **Option 4** proposes a statutory rate based on the Green Vehicle Guide (GVG) star rating of the vehicle. Variant 1 (hereafter Option 4-1) uses statutory rates based on the 2008 GVG environmental star ratings, whereas Variant 2 (hereafter Option 4-2) uses statutory rates based on assumed 2014 GVG environmental star ratings.

The statutory rates for each option have been proportionally adjusted and are therefore revenue neutral, with the exception of Option 4-2, where the statutory rates are not revenue neutral (i.e. impacts in 2014 are calculated using 2008 rates) to allow for comparison with the other options.

REVENUE IMPACT OF MCMS FBT OPTIONS

Estimates of the first round revenue impact of MCMS-proposed FBT options are based on detailed unit record data provided by MCMS that includes information on 20,280 novated lease holders. These data were used in the following way:

- ❑ Step 1: Estimate the aggregate taxable value of 'benefit' for the sample reported in the MCMS dataset (the sample varies according to the option because some criteria are only available for a limited subset of the sample).
- ❑ Step 2: Estimate the aggregate taxable value of the 'benefit' for the sample reported in the MCMS dataset under an initial set of statutory rates provided by MCMS for the four options.
- ❑ Step 3: Estimate the percentage change in revenue for a given proposal (and common sample) using the aggregate taxable value of 'benefit' vehicles calculated in the previous steps.
- ❑ Step 4: Proportionally adjust original statutory rates provided by MCMS to generate revenue neutral statutory rates.

With the exception of Option 1, MCMS's initial statutory rates yielded tax revenue in excess of the amount estimated under the existing FBT arrangement. In these cases the initial

statutory rates were reduced to yield revenue neutral rates. In the case of Option 1 the rates were increased. For example, under Option 4-1, the taxable value of the 'benefit' vehicle (i.e. a vehicle that is concessionally taxed for FBT) is based on the same formula as the current arrangement, however it uses the statutory rate scale reported in the table below, which is linked to the GVG's environmental star ratings.

STATUTORY RATE UNDER MCMS OPTION 4-1

Rating	Green Vehicle Guide Rating	Initial Statutory Rate	Revenue Neutral Statutory Rate
Green	4 -5 Stars	7%	6.00%
Amber	3.5 Stars	11%	9.50%
Grey	3 Stars	20%	17.25%
Black	Less than 3 Stars	26%	22.25%

Applying the estimation methodology outlined above, the FBT revenue paid by users of 'benefit' vehicles under MCMS's initial Option 4-1 statutory rates is estimated to be 17% higher than the current FBT level. In value terms, Option 4-1 is expected to add \$314 million to revenue in 2008-09, yielding total revenue for this FBT line item of \$2,189 million in 2008-09. To put this scheme on a revenue basis with regard to the current scheme, the initial statutory rate schedule was adjusted proportionally to the nearest $\frac{1}{4}$ of a percentage point.

AUTO DEMAND IMPACT OF MCMS OPTIONS

Replacing the current concessional FBT arrangement for 'benefit' vehicles with MCMS FBT options will also impact upon the Australian automotive industry in terms of price, market structure and demand. To determine the possible impacts, four scenarios are analysed:

- ❑ **Scenario 1:** Removal of the current concessional FBT arrangement for 'benefit' vehicles.
- ❑ **Scenario 2:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 3 (i.e. statutory rates are based upon total emissions).
- ❑ **Scenario 3:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 4-1 (i.e. statutory rates are based upon GVG star ratings).
- ❑ **Scenario 4:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 4-2 (i.e. statutory rates are based upon MCMS's assumed 2014 GVG star ratings).

The auto demand analysis relies on a sample of 'benefit' vehicle data provided by MCMS and sale price and quantity data for the broader automotive industry provided by the Federal Chamber of Automotive Industries (FCAI) and Glass's Information Services Pty Ltd.

Data provided are used to estimate an econometric model of Australian automotive demand. This model is a partial equilibrium model in the sense that it assumes that the overall spending on automobiles remains fixed and, subject to that constraint, determines the value and volume of demand for different vehicle types based on changes in relative vehicle prices. In the case of the FBT analysis, the model is further simplified by assuming that the market is segmented into those buyers that plan to consume a 'benefit' vehicle and those that do not. Therefore the underlying assumption is that the overall spending on 'benefit' vehicles remains fixed.

Detailed data provided by MCMS on the annual income, vehicle leasing and operating costs, kilometres travelled and vehicle types of current leasing customers is used to calibrate the model, with regard to current FBT benefits, and values and volumes of demand for different types of 'benefit' vehicles.

Key Findings

Completely removing the current FBT arrangement implies very large effective price increases (in the range of 30% to 40%) for 'benefit' vehicles. Accordingly, the Scenario 1 modelling results demonstrate that total 'benefit' vehicle sales are expected to fall 25% to 31% below their current level. The locally produced large vehicle market is especially impacted, in line with the findings that 'benefit' vehicles account for 38% of large vehicle sales and 69% of all locally produced 'benefit' vehicles sold are large vehicles.

The modelling indicates that there is a negligible impact on the total volume of vehicle sales under Scenarios 2 and 3, which is unsurprising given that the statutory rates are revenue neutral. However, there are important compositional changes to the types of vehicles sold. In general, there is a shift towards fuel efficient vehicles, driven by changes in the relative effective prices of 'benefit' vehicles. In particular, demand for imported small vehicles and SUVs is expected to increase, while demand for locally produced large and medium vehicles and SUVs is expected to decrease.

Scenario 3, the MCMS-preferred option, yields the following results:

- ❑ The effective price of large vehicles will rise by 2.4% to 3.9%. The effective prices of other relatively high emitting vehicles, such as local SUVs and commercial vehicles, are also estimated to rise, while the effective prices of smaller vehicles, including imported SUVs, are expected to fall.
- ❑ Demand for total 'benefit' vehicles is expected to fall by 0.1% to 0.4%. The impact on vehicle segments varies considerably, with small vehicle, SUV and upper/large vehicle sales expected to increase, whereas large, medium and light/people-mover vehicle sales are expected to decrease.
- ❑ Demand for locally produced 'benefit' vehicles is estimated to fall by 4.4% to 7.8%.
- ❑ There will be a negligible impact on the total sales of all vehicle types, with total sales expected to fall by less than 0.1%. However, total sales of locally produced vehicles (which account for a large proportion of 'benefit' vehicles) are estimated to decrease within the range of 1.5% to 2.7%.
- ❑ The fall in demand of high emitting 'benefit' vehicles is offset by an increase in demand of lower emitting 'benefit' vehicles, which implies a modest reduction in total 'benefit' vehicle emissions. The average reduction in emissions per substituted 'benefit' vehicle is around 20% (i.e. outgoing less-efficient vehicles emit roughly 5 tonnes per year, while the incoming more-efficient vehicles emit roughly 4 tonnes per year).

In contrast, under Scenario 4, demand for total 'benefit' vehicles is expected to rise by 6.5% to 9.2%, depending on assumed employee contribution. There is strong growth in large and medium vehicle sales, especially locally produced large vehicles, where sales are expected to rise by 3.5% to 4.6%. These results reflect the lower effective prices that are implied by higher efficiency (i.e. by 2014, emissions per vehicle are assumed to be 20% below their current levels). Significantly, after taking into account the increase in sales, total 2014 'benefit' vehicle emissions are expected to fall by 12.8% to 15.1% below the current level.

Access Economics and Lateral Economics, 2009

1. INTRODUCTION

Access Economics and Lateral Economics were commissioned by McMillan Shakespeare (MCMS) to prepare estimates of both the revenue impact and auto demand effects of alternative Fringe Benefit Tax (FBT) schemes proposed by MCMS.

Access Economics and Lateral Economics have not offered an opinion on the efficacy of the MCMS-proposed policies in this report. Therefore the report should not be interpreted as advocating or opposing the options proposed by MCMS.

MCMS has identified four options that could be used to replace the existing FBT formula:

- ❑ **Option 1** is a modified version of the current FBT system, with a greater number of gradations in the statutory rate scale.
- ❑ **Option 2** is modelled on the UK's Emissions Rating scheme, with lower emission vehicles (measured by their CO2 emissions per kilometre) subject to a lower rate.
- ❑ **Option 3** incorporates aspects of both the UK CO2 scheme and the current FBT scheme by basing the statutory rate on total emissions, with the rate schedule rising as vehicle mileage (and CO2 emissions) increase.
- ❑ **Option 4** proposes a statutory rate based on the Green Vehicle Guide (GVG) star rating of the vehicle. Variant 1 (hereafter Option 4-1) uses statutory rates based on the 2008 GVG environmental star ratings, whereas Variant 2 (hereafter Option 4-2) uses statutory rates based on assumed 2014 GVG environmental star ratings.

Section 2 of the report outlines the existing FBT arrangement and then provides estimates of the first round (i.e. no behavioural change) revenue impact of the four options proposed by MCMS.

Section 3 describes the econometric model of Australian auto demand and explores the impact on the Australian automotive industry under four scenarios:

- ❑ **Scenario 1:** Removal of the current concessional FBT arrangement for 'benefit' vehicles.
- ❑ **Scenario 2:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 3 (i.e. statutory rates are based upon total emissions).
- ❑ **Scenario 3:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 4-1 (i.e. statutory rates are based upon GVG star ratings).
- ❑ **Scenario 4:** The existing FBT arrangement for 'benefit' vehicles is replaced with Option 4-2 (i.e. statutory rates are based upon MCMS's assumed 2014 GVG star ratings).

The analysis relies heavily on a sample of 'benefit' motor vehicle data provided by MCMS. These data contain detailed unit records on 20,280 novated lease holders for the 2007-08 tax year. Typical caveats therefore apply with regard to micro-datasets in that they may not be representative of the population data. However, MCMS's dataset constitutes a relatively large share of the population of leased vehicles.

2. REVENUE IMPACT OF ALTERNATIVE FBT OPTIONS

MCMS has identified four options that could be used to replace the existing FBT arrangement for 'benefit' vehicles. This section provides estimates of the first round (i.e. no behavioural change) revenue impact of these proposals.

2.1 EXISTING FBT ARRANGEMENT

'Benefit' motor vehicles, which include privately registered vehicles operating under a novated lease, and government and non-government vehicles provided by employers for private use, are concessionally taxed for FBT.

Under the current FBT system, the taxable value of a 'benefit' vehicle is calculated using the statutory rate formula:

$$\text{Taxable Value} = A \times B \times C/D - E$$

where:

A = the cost value of the car

B = the statutory rate

C = the number of days in the FBT year when the car was used or available for private use of the employee

D = the number of days in the FBT year

E = the employee post-tax contribution (if any).

Table 1 sets out the statutory rates used in the existing FBT arrangement:

TABLE 1: STATUTORY RATES FOR THE EXISTING FBT ARRANGEMENT

Total kilometres travelled during the FBT year (annualised)	Statutory rate
Less than 15,000	26%
15,000 to 24,999	20%
25,000 to 40,000	11%
Over 40,000	7%

The actual FBT of a motor vehicle provided to the employee by the employer is calculated using the following formula:

$$\text{FBT} = \text{Taxable Value} \times \text{Gross-up factor} \times \text{FBT rate}$$

There is no official measure of the breakdown of FBT revenue by type of benefit. In order to make progress the analysis here follows the approach of Warren (2006) in estimating

revenue by type using the taxable value of benefit reported by the Australian Tax Office (ATO).¹

According to the latest ATO tax statistics for tax-year 2005-06 the taxable value of benefits relating to cars using the statutory formula for the 2006-07 FBT year was \$1,621 million. Note this figure is net of Australian Government department FBT statistics.

Using a gross-up factor of 2.0647 and an FBT rate of 46.5% implies that the revenue collected from FBT due to cars using the statutory formula for the 2006-07 FBT-year was \$1,558 million (again this figure is net of Australian Government department FBT statistics). This revenue represented 46% of the total revenue collected for the 2006-07 FBT-year. Applying this method to earlier years suggests that this share has varied little over the life of the current taxing arrangement.

Table 2 applies this share to the Treasury's latest estimates of the future total FBT collections reported in Australian Government Budget Paper 1, Statement 5 to get an estimate of the expected revenue attributable to cars using the statutory formula. According to these estimates the expected revenue paid by 'benefit' vehicle users under the current statutory rate formula is \$1,875 million for 2008-09.

TABLE 2: ESTIMATED REVENUE OF FBT OPTIONS USING INITIAL STATUTORY RATES

\$ million	2008-09	2009-10	2010-11	2011-12
Total FBT	4,110	4,190	4,260	4,145
FBT - Cars using statutory formula	1,875	1,912	1,944	1,891
FBT – Option 1	1,684	1,717	1,745	1,698
FBT – Option 2	3,171	3,233	3,287	3,198
FBT – Option 3	2,597	2,648	2,692	2,619
FBT – Option 4-1	2,189	2,232	2,269	2,208

2.2 COSTING MCMILLAN SHAKESPEARE'S FBT OPTIONS

Estimates of the first round revenue impact of MCMS-proposed FBT options are based on detailed unit record data provided by MCMS that includes information on 20,280 novated lease holders. These data were used in the following way:

- ❑ Step 1: Estimate the aggregate taxable value of 'benefit' for the sample reported in the MCMS dataset (the sample varies according to the option because some criteria are only available for a limited subset of the sample).
- ❑ Step 2: Estimate the aggregate taxable value of the 'benefit' for the sample reported in the MCMS dataset under an initial set of statutory rates provided by MCMS for the four options.
- ❑ Step 3: Estimate the percentage change in revenue for a given proposal (and common sample) using the aggregate taxable value of 'benefit' vehicles calculated in the previous steps.
- ❑ Step 4: Proportionally adjust original statutory rates provided by MCMS to generate revenue neutral statutory rates.

¹ Warren, N. (2006) Fringe benefit tax design: Decision time, The Institute of Chartered Accountants in Australia, February 2006.

2.2.1 OPTION 1 – STATUTORY RATE BASED ON ANNUAL KILOMETRES TRAVELLED

Option 1 is a modified version of the current system, with a greater number of gradations in the statutory rate scale (see Table 3).

TABLE 3: STATUTORY RATE UNDER OPTION 1

Km range	Initial Statutory Rate	Revenue Neutral Statutory Rate
0 -14,000	26%	29.00%
14,001 - 16,000	21%	23.50%
16,001 - 18,000	19%	21.25%
18,001 - 20,000	17%	19.00%
20,001 - 22,000	15%	16.75%
22,001 - 24,000	13%	14.50%
24,001 - 26,001	11%	12.25%
26,001 - 34,000	10%	11.25%
34,001 - 40,000	9%	10.00%
40,000 +	7%	7.75%

The estimation methodology outlined above implies that the FBT revenue paid by users of ‘benefit’ vehicles under the initial Option 1 statutory rates provided by MCMS would be 10% lower than the current tax take. In other words, this option would reduce revenue by \$191 million in 2008-09, yielding total revenue for this line item of \$1,684 million in 2008-09 (see Table 2). This reflects the fact that the proposed scale imposes a lower burden per kilometre travelled than the current scheme.

The revenue neutral statutory rates under Option 1, which are the initial rates adjusted proportionally adjusted to the nearest ¼ of a percentage point, are reported in column 3 of Table 3.

These revenue estimates and tax rates estimates rely on the same basic information as that used in the current FBT scheme. This means that the estimates are based on a relatively large sample of novated lease holders, with around 88% of the total sample of 20,280 provided by MCMS used in the calculations. The shortfall reflects missing information on kilometres travelled or days the car was available (i.e. subject to FBT).

2.2.2 OPTION 2 – STATUTORY RATE BASED ON VEHICLES’ EMISSIONS RATING (UK MODEL)

Option 2 is based on the UK’s Emissions Rating scheme with lower emission cars (measured by their CO2 emissions per kilometre) subject to a lower statutory rate. MCMS’s initial statutory rates for this option are reported in Table 4.

Applying the methodology implies that the FBT revenue paid by users of ‘benefit’ vehicles under the initial Option 2 statutory rates provided by MCMS would be 69% higher than the current tax take. In value terms option 2 is expected to increase revenue by \$1,296 million in 2008-09, raising total revenue for this line item to \$3,171 million in 2008-09 (see Table 2).

Column 3 of Table 4 reports the adjusted statutory rates under Option 2 that yield the same revenue as the current scheme. Again rates have been adjusted to the nearest ¼ of a percentage point.

TABLE 4: STATUTORY RATE UNDER OPTION 2

CO2 Emissions (g/km)	Initial Statutory Rate	Revenue Neutral Statutory Rate
< 140	5.0%	3.00%
145	6.3%	3.75%
150	7.5%	4.50%
155	8.8%	5.25%
160	10.0%	6.00%
165	11.3%	6.75%
170	12.5%	7.50%
175	13.8%	8.25%
180	15.0%	9.00%
185	16.3%	9.75%
190	17.5%	10.50%
195	18.8%	11.25%
200	20.0%	12.00%
205	21.3%	12.75%
210	22.5%	13.50%
215	23.8%	14.25%
220	25.0%	15.00%
225	26.3%	15.75%
230	27.5%	16.50%
235	28.8%	17.25%
> 235	30.0%	18.00%

The informational requirements for costing this option are greater than the current FBT scheme, since it requires data on the emissions rating of individual vehicles. MCMS's database has limited information on emissions, with CO2 emissions per kilometre reported for roughly 17% of the total 20,280 leased vehicle sample. In general, prediction error is inversely related to the size of the sample underlying the prediction, with smaller samples implying larger prediction errors. This suggests that there is a larger margin of error underlying the revenue estimates for Option 2 than would be expected if the full sample was used.

2.2.3 OPTION 3 – STATUTORY RATE BASED ON ACTUAL TONNES OF CO2 EMITTED

Option 3 incorporates aspects of both the UK CO2 scheme and the current FBT scheme by basing the statutory rate on total tax year emissions. In contrast to the current schedule, the statutory rate schedule proposed by MCMS rises with vehicle mileage (see Table 5).

Repeating the earlier approach suggests that the FBT revenue paid by users of 'benefit' vehicles under the initial Option 3 statutory rates provided by MCMS would be 39% higher than the current tax take. In other words, total revenue for this line item under the initial statutory rates is expected to be \$2,597 million in 2008-09, which represents an expected increase in revenue by \$722 million (see Table 2).

TABLE 5: STATUTORY RATE UNDER OPTION 3

Tonnes of CO2	Initial Statutory Rate	Revenue Neutral Statutory Rate
1	7.0%	5.00%
2	8.5%	6.25%
3	10.0%	7.25%
4	20.0%	14.50%
5	25.0%	18.00%
6	30.0%	21.75%
7	32.5%	23.50%
8	35.0%	25.25%
9	37.5%	27.00%
10	40.0%	29.00%

Column 3 of Table 5 reports the proportionally adjusted statutory rate schedule under option 3 that yields the same revenue as the current FBT scheme.

2.2.4 OPTION 4-1 – STATUTORY RATE BASED ON VEHICLES ENVIRONMENTAL RATING

Option 4-1 proposes a statutory rate based on the overall environmental rating of the vehicle, where the environmental rating is explicitly tied to the 5 star environmental rating reported by the Green Vehicle Guide (www.greenvehicleguide.gov.au). The Green Vehicle Guide (GVG) ratings are calculated using data provided by manufacturing from testing vehicles against Australian standards. A vehicle's overall environmental rating is based on its air pollution and greenhouse ratings. Equal weighting is given to both these components to arrive at a combined GVG rating out of 20, which is then translated into a 5 star rating. More environmentally friendly vehicles have a higher star rating.

Under this option the taxable value of the 'benefit' is based on the same formula as the current arrangement, however it uses the statutory rate scale reported in Table 6, which is linked to the GVG's environmental star ratings.

TABLE 6: STATUTORY RATE UNDER OPTION 4-1

Rating	Green Vehicle Guide Rating	Initial Statutory Rate	Revenue Neutral Statutory Rate
Green	4 -5 Stars	7%	6.00%
Amber	3.5 Stars	11%	9.50%
Grey	3 Stars	20%	17.25%
Black	Less than 3 Stars	26%	22.25%

Using the estimation methodology outlined above implies that the FBT revenue paid by users of 'benefit' vehicles under MCMS's initial Option 4-1 statutory rates would be 17% higher than the current FBT take. In value terms, Option 4-1 is expected to add \$314 million to revenue in 2008-09 (see Table 2), yielding total revenue for this line item of \$2,189 million in 2008-09 (see Table 2). The proportionally adjusted revenue neutral rates for this option are reported in Column 4 of Table 6.

MCMS's GVG information is limited to new vehicles, so the revenue estimates reported in Table 2 are based on a relatively small sample of novated lease holders, with only 11% of the total sample of 20,280 used in the making the calculations.

2.2.5 OPTION 4-2– UNDER ASSUMED ENVIRONMENTAL RATING AS AT 2014

MCMS also requested modelling to assess the impact on future revenue years (e.g. in 2014) if the revenue neutral statutory rates proposed for Option 4-1 were maintained under an assumed improvement in the environmental rating of all 'benefit' vehicles. In particular, MCMS requested revenue estimates under the assumptions that:

- ❑ The 2014 GVG star rating of all vehicles in 2014 will be one star level above their current 2008 rating; and
- ❑ The average fall in CO2 emissions per vehicle in 2014 is to be equal to the average percentage change in the level of emissions per star rating estimated from the MCMS dataset (estimated to be around 20%).

For comparability with the earlier results, the impact of this scenario is calculated in terms of the 2008-09 (to 2011-12) revenues. Following the same methodology used above, Option 4-2 revenue yields the revenue estimates reported in Table 7.

TABLE 7: ESTIMATED REVENUE IMPACT OF OPTION 4-2

\$ million	2008-09	2009-10	2010-11	2011-12
Current statutory formula	1,875	1,912	1,944	1,891
Option 4 with 2014 star rating	1,050	1,071	1,088	1,059
Net revenue	-825	-841	-855	-832

Under these assumptions Option 4-2 is expected to yield only 56% of the current FBT revenue. In 2008-09 dollars this implies revenue of \$1,050 million, which is a shortfall of \$825 million over the revenue estimated under the current FBT arrangement.

3. AUTO INDUSTRY IMPACT OF ALTERNATIVE FBT OPTIONS

This section explores the impact on the Australian automotive industry of removing the current concessional FBT arrangement for 'benefit' motor vehicles. The analysis relies on a sample of 'benefit' motor vehicle data provided by MCMS and sale price and quantity data for the broader automotive industry provided by the Federal Chamber of Automotive Industries (FCAI) and Glass's Information Services Pty Ltd.

Data provided by the FCAI and Glass's is used to estimate a model of automotive demand. This model is a partial equilibrium model in the sense that it assumes that the overall spending on automobiles remains fixed and, subject to that constraint, determines the value and volume of demand for different vehicle types based on changes in relative vehicle prices. In the case of the FBT analysis the model is further simplified by assuming that the market is segmented into those buyers that plan to consume a 'benefit' vehicle and those that do not. Therefore the underlying assumption is that the overall spending on 'benefit' vehicles remains fixed.

Detailed data provided by MCMS on the annual income, vehicle leasing and operating costs, mileage and vehicle types of current leasing customers is used to calibrate the model, with regard to current FBT benefits, and values and volumes of demand for different types of 'benefit' vehicles.

3.1 DEFINING AUTOMOTIVE SEGMENTS

To make the analysis tractable it is necessary to define automobile segments. The classification of vehicles in the Australian automotive industry used by FCAI and in the VFACTS reports is based primarily on the size of the vehicle, the gross vehicle mass and the predominant purpose for which the vehicle was designed. This report basically follows the VFACTS classifications.

At the top level, vehicles are classified as either a passenger motor vehicle or a commercial vehicle. In the passenger motor vehicle class, vehicles are predominantly a means of conveyance or transportation of persons from one location to another. In contrast, commercial vehicles are a means of transporting goods, as well as persons, from one location to another.

For the purposes of this analysis, sport utility vehicles (SUVs) are seen as closer to passenger motor vehicles than to commercial vehicles and so are included in the passenger motor vehicle classification.

3.1.1 SEGMENTS

A **light** vehicle can either be a hatch or sedan. Light vehicles are typically smaller in dimension and engine capacity than small vehicles, but are similar in other aspects. Examples of light vehicles include the Toyota Starlet and the Honda Jazz, with variants of each having small four cylinder engines of less than 1400cc.

Similarly, **small** and **medium** vehicles also have four cylinder engines, but have higher engine capacities of at least 1400cc and 1900cc, respectively. Typical examples of small and medium vehicles include the Toyota Corolla (small) and the Audi A4 or Toyota Camry (medium).

The **large** and **upper large** segments are similar in most respects, with an upper large vehicle having slightly larger dimensions relative to a similarly equipped large vehicle. A typical large or upper large vehicle would be equipped with a six or eight cylinder engine and would be a sedan or wagon. Examples include the Toyota Aurion (large) and the Holden Statesman (upper large).

Examples of **people movers** are the Honda Odyssey and the Chrysler Voyager.

An **SUV** is typically a four wheel drive with high ground clearance and closed cargo space. Examples include the Honda CRV and the Ford Territory.

Sports vehicles are in a distinct segment. A typical sports vehicle is a convertible or coupé and the segment includes the expensive marques such as Porsche, as well as the Honda Integra and the Mazda MX5.

For various statistical reasons the estimated model of Australian automotive demand captures the behaviour of six passenger vehicle segments: large, small, medium, SUV, combined light and people movers, and combined upper large and sports.

3.1.2 COMMERCIAL VEHICLES

The 4X2 and 4X4 pickup/cab-chassis segment of the commercial vehicle sector is also included in the analysis. For simplicity, we refer to vehicles in the commercial segment as either 4X2 commercial or 4X4 commercial, without further distinguishing between pick-ups and cab-chassis.

Competitive influences on commercial vehicles are modelled separately from those on the passenger motor vehicles. While there are overlaps between the segments, a key distinguishing feature is that passenger vehicles are designed primarily to transport people from one location to another, whereas commercial vehicles are designed to transport goods and materials.

3.1.3 COUNTRY OF ORIGIN

Passenger motor vehicles and commercial vehicles are also classified according to whether the country of origin is Australia (**locally manufactured**) or overseas (**imported**). Passenger motor vehicles are locally manufactured by Ford, Holden, Mitsubishi and Toyota; and are imported from over 25 countries.

3.2 DATA SOURCES

Data on vehicle sales used in estimating the model were made available by FCAI. The VFACTS data gives monthly sales, covers the period January 1991 to August 2007, and contains data on segment, country of origin, marque, model, and so on.

Data on prices used in estimating the model were made available by Glass's Information Services Pty Ltd. The data gives prices quarterly, covers the period March 1993 to June 2008, and contains prices by marque, model, variant, and so on.

The sales data were aggregated from monthly to quarterly to match the price data. Seasonality is evident in the sales data whereas the price of a model is typically fixed throughout the year.

3.2.1 AUTOMOTIVE PRICE INDICES

It is straightforward to aggregate the sales data from individual models to segments and origin. Defining prices for the segments and origins is a more difficult task.

A price index is a numerical time series designed to help show how the price of some class of goods, taken as a whole, differs between time periods. By design, a price index reduces all the distinct prices for the class of goods in question to a single number. The classes of goods in question are the sets of vehicles in segment/origin combinations, such as small imported vehicles and large locally manufactured vehicles.

Some automotive price indices are currently available. Australian Automobile Intelligence (AAI) publishes price indices for locally manufactured and imported vehicles and the Australian Bureau of Statistics (ABS) produces a CPI motor vehicle index.

Those price indices are not at the level of aggregation needed in this project. Therefore price indices have been constructed for the segment and origin split.

We begin by discussing two methods for defining the prices of motor vehicles over time:

- average prices; and,
- chain price indices.

3.2.2 AVERAGE PRICES

The average price in the segment – the total value of vehicles sales divided by the number of vehicles – is not necessarily the best way to study prices over time. Average prices embody changes in the mix of marques and models within the segment and in the quality and specifications of the vehicles.

Improvements to vehicle specifications mean that consumers are getting more value in their purchases for every dollar amount spent. An obvious example is the inclusion of air conditioning and electric windows in many new vehicles as part of a standard package, rather than as options at additional cost to the consumer.

3.2.3 CHAIN PRICE INDICES

Chain price indices take into account the changes in the mix of marques and models within segments.

In particular, a model enters into the index measuring the price change over two periods only if it is sold in both of the periods. Hence, new marques and models do not appear in the index until the second period in which they are sold.

As an example, consider the upper large imported segment. For many years, the segment was dominated by the Audi A8 and the BMW 7 series, with prices of around \$200,000. In recent years, the Chrysler 300C appeared on the market, at a price of around \$60,000. In the first period in which the Chrysler sold, the average price for the segment fell from \$200,000 to around \$65,000. But the chain price index only includes the Chrysler in the second period in which it sold. The prices did not change between the first and second periods and so the chain price index is flat.

- The index comparing the two periods is formed from weighted averages of the prices, where the weights are the sales quantities in the first of the two periods. In other words, the index estimates the change in price for a fixed 'basket' of goods.

Extending the index from two periods to a longer period of time is done by 'chaining together' the two-period price comparisons.

The model estimation makes use of the chain price indices.

3.3 AN ECONOMETRIC MODEL OF AUSTRALIAN AUTO DEMAND

The specification of the econometric model begins with a theoretically sound economic model of demand. That economic model motivates the basic relationships between demand and its drivers. The structure of the equations in the econometric model follows the commonly used translog functional form.

3.3.1 THE UNDERLYING ECONOMIC MODEL OF AUTOMOBILE DEMAND

The underlying economic model assumes that there is a single representative consumer. This representative consumer has nested preferences in which they make the following sequence of decisions when buying an automobile:

- ❑ Given their aggregate level of consumption, the representative consumer faces the choice between buying automobiles or other goods. (The resulting demand for automobiles is referred to as aggregate demand.)
- ❑ Given their decision to buy automobiles, the representative consumer faces the choice between a 'benefit' and 'non-benefit' automobile. (This is referred to as 'benefit' segment demand.)
- ❑ Given their decision to consume a 'benefit' or 'non-benefit' automobile, the representative consumer faces the choice between the different segments. (This is referred to as segment demand.)
- ❑ Given the decision to buy automobiles within a segment, the representative consumer faces the choice of between locally manufactured and imported automobiles. (This is referred to as origin demand.)

This nested structure allows for the different stages of demand to be modelled separately, taking the previous step as given.

3.3.2 AGGREGATE AUTOMOBILE DEMAND

The possible drivers of aggregate automobile demand include:

- ❑ the aggregate level of consumption on all goods, which is a function of wealth and labour income;
- ❑ the constant quantity price index of automobiles;
- ❑ the constant quantity price index of other goods;
- ❑ the interest rate facing consumers buying automobiles on credit; and
- ❑ other costs of running an automobile (fuel, maintenance, insurance and road taxes).

A key assumption underlying this part of the model is that all prices, interest rates, and other costs are exogenous to model. That is, prices are determined outside of, or prior to, the vehicle purchase decision.

Automobiles are assumed to be normal, rather than inferior, goods. That is, holding all else constant, an increase in wealth and/or income is expected to raise the demand for

automobiles. Similarly, higher prices of other goods are expected to raise the demand for automobiles; while higher automobile prices, interest rates and running costs are expected to lower the demand for automobiles.

3.3.3 AUTOMOBILE SEGMENT DEMAND

The quantitative analysis reported here takes total value of demand for 'benefit' vehicles as given. This allows the analysis to focus on how the sales in each of the automobile segments respond to various economic drivers. The possible drivers underlying segment demand include:

- Aggregate automotive demand (given in the previous step).
- The typical prices within the segments.
- Other costs of running a car (fuel, maintenance, insurance and taxes).
- Shifts in underlying preferences between segments.

The model assumes that prices, preference shifts and other costs are exogenous to the decision to buy in one segment or another. This means that prices are treated as given in the segment demand model.

The economic model assumes that the representative consumer's choices across automobile segments are consistent with a utility-maximising framework – the consumer allocates spending across the segments, given the prices within those segments, in a manner which maximises his satisfaction or utility. That leads to the equations for the segment demands.

The dependent variables in those demand equations are the 'budget shares' – the shares of total spending for each of the segments. Hence, as noted above, the appropriate left hand side variable in the demand equation for a segment is the value share for that segment.

We model the value shares using translog functions. Translog functions are widely used in the estimation of utility and production/cost functions. The appeal of the translog stems from the fact that:

- its inputs are relatively easy to calculate;
- it is relatively easy to estimate with current computing technology; and
- it has proven to be a reliable framework for estimating utility and production/cost functions.

The equations are closely related to those in the almost ideal demand system.

The basic explanatory variables in the demand equations are the chain price indices for the individual segments. The share for each segment depends on the price for that segment as well as the prices for the other segments. It is expected that the share for a segment will fall when the price for that segment rises relative to the prices for other segments. The share for a segment may either rise or fall in response to a price increase for another segment, depending on the degree of substitutability between the segments. For example, we would expect some substitution between light vehicles and small vehicles; likewise for large and upper large vehicles. That is because the median price differential between the associated segments is likely to be small and, moreover, consumer preferences are likely to overlap across similar segments.

A price change for a segment also changes the overall demand for motor vehicles. For example, a price fall for imported vehicles may mean more money to spend on other goods, including locally manufactured goods.

The basic model can be expanded to include other factors potentially related to the value shares of segments, such as the price of petrol. Increases in that price are expected to shift demand away from large cars to smaller cars.

The interpretation of the estimated parameters is not straightforward. For example, the effect of a price change for a particular segment depends on both the direct effect on the segment as well as the indirect effect through other segments. Hence, we do not discuss the results here.

That said, we note that some of the car price responses are stronger in the model without petrol prices than in the model with petrol prices. For example, the model with petrol prices predicts a decline in the large segment as a result of an increase in petrol prices. The increase in petrol prices has occurred at the same time as the relative increase in the price of locally manufactured large cars. Hence, when petrol prices are not included in the model, some of their predicted effect on the large segment is taken up by the car price response.

The model with petrol prices is preferred on statistical grounds. First, the overall fit of the model with petrol prices is superior, with significantly more of the variation in value shares explained with the addition of petrol prices (after adjusting for the increase in the number of explanatory variables). This is especially true for the large segment in which the explained variation rises from 65% to 86%. Second, the coefficients on petrol prices are statistically different from zero. This means that, given the variables in the model without petrol prices, fluctuations in petrol prices have a statistically significant impact on value shares.

Since the current FBT arrangement lowers the effective cost of petrol and other leasing costs proportionally the petrol price effect identified in the model has no bearing on the demand impact estimates.

3.3.4 AUTOMOBILE ORIGIN DEMAND

The representative consumer is also faced with the option of buying an automobile manufactured locally or imported. Within the nested preference structure the main drivers of origin demand are:

- ❑ Aggregate segment demand (from the previous step); and
- ❑ The price indices of locally manufactured and imported vehicles within the segment.

Again, the model assumes that prices are exogenous to decision. Petrol prices are not included in the model under the assumption that changes in petrol prices have similar effects on the demands for locally manufactured and imported vehicles.

The translog functional form is again employed.

3.4 SCENARIO ANALYSIS

This section estimates the impact on Australian automobile demand under four scenarios:

- ❑ **Scenario 1:** Removal of the current concessional FBT arrangement for 'benefit' vehicles.

- ❑ **Scenario 2:** The existing FBT arrangement for ‘benefit’ vehicles (summarised in Table 1) is replaced with Option 3 (i.e. statutory rates are based upon total CO2 emissions summarised in Table 5).
- ❑ **Scenario 3:** The existing FBT arrangement for ‘benefit’ vehicles (summarised in Table 1) is replaced with Option 4-1 (i.e. statutory rates are based upon GVG star ratings summarised in Table 6).
- ❑ **Scenario 4:** The existing FBT arrangement for ‘benefit’ vehicles (summarised in Table 1) is replaced with Option 4-2 (i.e. statutory rates are based upon MCMS’s assumed 2014 GVG star ratings).

3.4.1 SCENARIO 1 – REMOVING THE EXISTING FBT ARRANGEMENT

Estimated effective price change

The existing concessional FBT arrangement lowers the effective price of a ‘benefit’ vehicle. Estimating the size of this effective price reduction relies on estimates of the actual benefit enjoyed by leasing customers under the current FBT arrangement. Data provided by MCMS on customer incomes, mileage, leasing and operating costs and vehicles types is used to calculate the increase in effective vehicle price. On the advice of MCMS, the average time of a lease is assumed to be three years, with a residual value of 45%.

According to the sample provided by MCMS for 2007-08 tax year, which included detailed data on 12,410 customers, the increase in the effective price of a ‘benefit’ vehicle if the existing FBT arrangement was removed depends on the extent of the customer’s post tax contributions. For example, the average percentage increase for consumers of large ‘benefit’ vehicles is estimated to be 33.4% if the customer makes no post-tax contribution and 44.7% for customers that make a post-tax contribution (see Table 8 below).

TABLE 8: INCREASE IN EFFECTIVE ‘BENEFIT’ VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution	44.8	43.8	42.8	45.7	42.5	44.3	46.9	44.7
No post-tax contribution	33.4	32.6	30.7	34.7	30.4	33.0	35.9	33.4

This table also shows that despite the variation in average price and operating costs across these different vehicle types, the estimated increase in effective vehicle prices are similar, with the highest effective price increase for SUVs roughly 4 percentage points higher than the lowest increase for the light/people mover segment. This suggests that there would be little substitution across different types of vehicles following the removal of the existing FBT arrangement.

Estimated size and importance of the ‘benefit’ vehicle market

MCMS has estimated that the total number of ‘benefit’ vehicles sales in 2007 was 176,660, with roughly 40% of sales accounted for by locally produced vehicles (see Table 9). According to their estimates the bulk of ‘benefit’ vehicles are purchased by private users. Vehicles are purchased under a variety of methods, with roughly one third of all ‘benefit’

sales involving a novated lease arrangement in which the employee effectively purchases the 'benefit' vehicle.

TABLE 9: 'BENEFIT' VEHICLE SALES

Type of vehicle sale	All vehicles (local and imported)	Australian made (local)
Novated lease (privately registered)	46,667	9,333
Government 'benefit' vehicle	16,000	14,850
Non-Government 'benefit' vehicle	113,993	44,900
Total	176,660	69,083

The relative importance of 'benefit' sales by vehicle type is estimated using MCMS's 'benefit' sales estimates and data on the total number of sales in 2006-07 provided by the FCAI. According to these data, 'benefit' vehicles accounted for 21% of the total sales vehicles in 2006-07.

The total number of 'benefit' vehicles by type is estimated by combining total sales with the total and local distribution of 'benefit' vehicles derived from the MCMS novated lease data.

TABLE 10: DISTRIBUTION OF 'BENEFIT' VEHICLES BY TYPE

Sales measure	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm- ercial
Volume share: Total sales	27%	12%	17%	27%	7%	2%	7%
Volume share: Local sales	69%	12%	0%	11%	0%	2%	6%
Value share: Total sales	26%	12%	14%	33%	6%	2%	7%
Value share: Local sales	67%	9%	0%	15%	0%	2%	7%

At around 27% of the total 'benefit' market sales, the largest individual segments by volume are large vehicles and SUVs. Jointly these segments account for 54% of the total volume of 'benefit' vehicle sales (see Table 10). The SUV value share is somewhat higher than that of large vehicles because the average price of an SUV in the sample is around \$40,000, while the average price of a large vehicle in the sample is much lower at \$32,000. Medium and small vehicles combined make up roughly 30% of the volume of 'benefit' sales and a slightly smaller share of the value of sales.

Large vehicles dominate the sales of locally made 'benefit' vehicles, with 69% of the volume and 67% of the value of all locally produced 'benefit' vehicles sold attributable to large vehicles. This reflects the fact that local vehicle production is concentrated in large vehicles. The next largest categories are medium vehicles and SUVs, which make up roughly 23% of the volume and value of all locally produced 'benefit' vehicles sold.

TABLE 11: 'BENEFIT' SHARE OF TOTAL SALES BY SEGMENT

Sales measure	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
'Benefit' vehicle share of total sales in segment	38%	29%	14%	36%	10%	18%	8%	21%
'Benefit' vehicle share of local sales in segment	39%	29%	0%	40%	0%	18%	17%	34%

Turning to individual segments, 'benefit' cars account for 38% of large vehicle sales. This is closely followed by SUVs, with a 36% share, and medium vehicles, with a 29% share. 'Benefit' vehicles account for a smaller proportion of the small, light, people-mover, upper large and sport segments.

The 'benefit' vehicle share of local sales is similar to that of total vehicle sales, however, 'benefit' vehicles account for 34% of total locally produced vehicle sales, which compares with a 'benefit' vehicle share of total sales of 21%. This suggests that the greatest impact of the removal of the existing FBT arrangement will be on the locally produced large, SUV and medium vehicle segments.

Estimated impact on auto industry demand

The impact on 'benefit' market segment volume and value of sales is estimated using:

- ❑ the change in value of sales shares for different types of vehicles estimated by the automotive segment demand model described above;
- ❑ the estimated change in effective 'benefit' vehicle price; and
- ❑ the estimated total value of annual 'benefit' sales (estimated at \$5.9 billion for 2006-07).

Combining these three pieces of information implies the change in 'benefit' vehicle sales reported in Table 12. The auto demand model relies on changes on relative prices. Given the similarity of the estimated change effective prices the model predicts a slight change in value shares of different vehicles under Option 3. The biggest influence on demand, therefore, is the increase in effective prices.

TABLE 12: ESTIMATED IMPACT ON 'BENEFIT' VEHICLE SALES FROM REMOVING FBT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution: Total sales	-32.2	-29.5	-30.1	-30.4	-29.4	-38.0	-31.9	-30.9
Post-tax contribution: Local sales	-32.2	-29.8	0.0	-30.2	0.0	-53.4	-30.6	-31.9
No post-tax contribution: Total sales	-24.8	-18.9	-26.3	-26.0	-24.1	-37.0	-26.4	-24.9
No post-tax contribution: Local sales	-24.9	-19.6	0.0	-25.4	0.0	-48.9	-24.4	-24.7

Demand for total 'benefit' vehicles is expected to fall by 24.7% to 30.9%, depending on assumed employee contribution. Table 12 shows that the impact on different vehicle types is similar to the impact on total sales. For example, in the case where employees make post-tax contributions, the estimated impact ranges from an expected decline in light/people-mover vehicles of 24.9% to upper-large/sport vehicles of 38.0%.

A similar picture emerges for locally produced 'benefit' vehicle sales. Demand for all locally produced 'benefit' vehicles is estimated to fall by 24.9% to 31.9% %, depending on assumed employee contribution. The change in the expected volume of sales is similar across segments with demand for locally produced large, medium and SUVs expected to fall by around 30% in the post-tax contribution case. In terms of 2007 sales that represents an expected fall in demand of 22,062 locally produced vehicles.

TABLE 13: ESTIMATED IMPACT ON TOTAL VEHICLE SALES FROM REMOVING FBT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution: Total sales	-12.2	-8.4	-4.1	-11.0	-2.8	-6.9	-2.7	-6.4
Post-tax contribution: Local sales	-12.5	-8.5	0.0	-12.2	0.0	-9.8	-5.1	-10.9
No post-tax contribution: Total sales	-9.4	-5.4	-3.6	-9.4	-2.3	-6.7	-2.2	-5.2
No post-tax contribution: Local sales	-9.7	-5.6	0.0	-10.3	0.0	-9.0	-4.0	-8.4

'Benefit' sales are estimated to be roughly 21% of total vehicle sales which implies a fall in aggregate demand for vehicles is of 5.2% to 6.4%, depending on assumed employee contribution. Table 13 shows that the biggest impact is expected to be in the large vehicle market with the fall in total demand ranging from 9.4% to 12.2%.

Around 40% of locally produced sales are attributable to ‘benefit’ sales. Therefore the estimated impact on total local demand is somewhat higher, with the expected fall in sales ranging from 8.4% to 10.9%, depending on assumed employee contribution. This decline reflects in large part the impact on locally produced large vehicle demand.

3.4.2 SCENARIO 2 – STATUTORY RATE BASED ON ACTUAL TONNES OF CO2 EMITTED

Estimated effective price change

Table 14 reports the estimated impact on effective vehicle prices in shifting from the current FBT statutory rate system to that proposed for Option 3. These estimates are based on the actual tax and emissions data of existing novated lease holders supplied by MCMS for the 2007-08 tax year and the revenue neutral tax rates derived above.

This option appears to have a negligible impact on the effective cost of the average ‘benefit’ vehicle. In fact, the effective price of the average ‘benefit’ vehicle is expected to fall slightly under this option. The prices of large vehicles and SUVs are however expected to rise and that is reflected by an increase in the effective prices of local ‘benefit’ vehicles.

TABLE 14: OPTION 3 INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	0.2	-3.1	-3.7	1.3	-2.4	-7.0	3.5	-0.4
Post-tax contribution: Local sales	0.0	-4.3	0.0	9.3	0.0	-7.0	2.6	1.0
No post-tax contribution: Total sales	1.4	-4.0	-5.0	2.2	-3.9	-9.6	5.8	-0.1
No post-tax contribution: Local sales	0.9	-5.2	0.0	14.6	0.0	-9.6	4.3	2.3

Estimated impact on auto industry demand

The auto demand model predicts that expected change in relative effective prices under Option 3 will lead to relatively small changes in the value shares of different ‘benefit’ vehicle segments. Combining these model predictions with changes in effective prices implies the impacts on ‘benefit’ vehicles sales reported in Table 15.

TABLE 15: OPTION 3 ESTIMATED IMPACT ON 'BENEFIT' VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	3.9	0.3	7.0	-3.1	-16.4	35.3	-3.3	0.6
Post-tax contribution: Local sales	4.1	1.8	0.0	-9.9	0.0	26.7	-2.6	2.2
No post-tax contribution: Total sales	2.6	-0.8	9.7	-3.1	-19.4	44.7	-5.5	0.4
No post-tax contribution: Local sales	3.3	0.9	0.0	-13.5	0.0	34.1	-4.1	1.2

There is very little change in demand for total 'benefit' vehicles, with sales expected to rise under Option 3 by between 0.4% and 0.6%, depending on assumed employee contribution. The impact on different vehicle segments varies greatly with SUV, light/people-mover and commercial sales expected to decline, while large, medium, small, and upper-large/sport sales are expected to rise.

Similarly, demand for all locally produced 'benefit' vehicles is estimated to rise by 1.2% to 2.2%, depending on assumed employee contribution. Underlying this estimate is a modest increase in large vehicles sales that is partly offset by a strong reduction in demand for SUVs.

Local vehicles sales increase under Option 3, despite experiencing higher prices, because the negative effect of their higher relative prices is more than offset by a positive income effect resulting from the fall in total vehicle prices. This is best illustrated by a simple two good example where the price of just one good falls and the goods are poor substitutes. In this case, relative price changes imply little substitution between goods. Since a price fall in one good means that you can buy more of both goods, this leads to greater demand of both goods. This is essentially what is occurring in the 'benefit' vehicle market in Option 3. The auto demand model suggests that there is little to no substitution between large and small cars. Under Option 3 the price of small vehicles is somewhat lower, but the price of large cars is roughly unchanged. Therefore, given that there is little substitution between small and large cars, the less expensive small vehicles imply an increase in both small and large vehicle sales.

Table 16 reports the impact of Option 3 on the total vehicle market. With the exception of the relatively small, upper-large/sports market, the impact on segment demand is expected to be negligible. The impact on the total vehicle market is also minuscule with sales expected to rise by 0.1% under Option 3.

TABLE 16: OPTION 3 ESTIMATED IMPACT ON TOTAL VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	1.5	0.1	1.0	-1.1	-1.6	6.4	-0.3	0.1
Post-tax contribution: Local sales	1.6	0.5	0.0	-4.0	0.0	4.9	-0.4	0.8
No post-tax contribution: Total sales	1.0	-0.2	1.3	-1.1	-1.9	8.1	-0.5	0.1
No post-tax contribution: Local sales	1.3	0.3	0.0	-5.5	0.0	6.3	-0.7	0.4

‘Benefit’ vehicles account for a larger share of locally produced sales, so the estimated impact on total local demand is somewhat higher. The estimated increase in local sales is expected to range between 0.8% and 0.4%, depending on assumed employee contribution. This increase reflects higher sales of locally produced large vehicles.

Estimated impact on emissions

Table 17 combines the estimated change in sales volume with the estimated average annual volume of emissions for each type of car derived from the MCMS novated lease data to estimate the impact on carbon emissions under Option 3. Option 3 implies a small increase in total emissions in the case of employee contributions and a slight decrease in the case of no employee contributions. This table also shows that increases in emissions flowing from greater sales of locally produced vehicles are fully or partially offset by falls in emissions from reduced sales of imported vehicles.

TABLE 17: OPTION 3 ESTIMATED IMPACT ON CARBON EMISSIONS (TONNES)

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	3,158	1,420
No post-tax contribution	475	-930

Table 18 expresses the reductions as a percentage of total ‘benefit’ vehicle emissions for 2007. Overall the policy option implies a negligible impact on ‘benefit’ vehicle emissions.

TABLE 18: OPTION 3 ESTIMATED REDUCTION IN 'BENEFIT' VEHICLE EMISSIONS

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	1.4%	0.2%
No post-tax contribution	0.2%	-0.2%

3.4.3 SCENARIO 3 – STATUTORY RATE BASED ON ENVIRONMENTAL RATING

Estimated effective price change

Table 19 reports the estimated impact on effective vehicle prices in shifting from the current FBT statutory rate system to that proposed for Option 4-1, based on the GVG star rating. Again, these estimates are based on the actual tax and emissions data of existing novated lease holders supplied by MCMS for the 2007-08 tax year and the revenue neutral tax rates derived above.

MCMS's data sample implies that the effective price of large vehicles will rise by 2.4% to 3.9% under the Option 4-1 statutory rate system. The effective prices of other relatively high emitting vehicles such as local SUVs and commercial vehicles are also estimated to rise by more than large vehicles, while the effective prices of smaller vehicles, including imported SUVs, are expected to fall.

TABLE 19: OPTION 4-1 INCREASE IN EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution: Total sales	2.4	-3.2	-4.0	1.3	-2.5	-6.2	6.4	0.3
Post-tax contribution: Local sales	2.4	-4.1	0.0	9.7	0.0	-6.2	4.1	2.8
No post-tax contribution: Total sales	3.8	-4.0	-5.6	1.8	-3.9	-8.5	10.0	0.6
No post-tax contribution: Local sales	3.9	-5.4	0.0	14.7	0.0	-8.5	7.9	4.6

Estimated impact on auto industry demand

The auto demand model suggests that the estimated changes in relative prices under Option 4-1 will lead to significant changes in share of sales of different 'benefit' vehicle segments. In particular, the share of sales of large, medium and light/people mover segments are expected to fall under Option 4-1.

Combining these value share estimates, with estimates of the effective vehicle price under Option 4-1, implies the impacts on 'benefit' vehicles sales reported in Table 20.

TABLE 20: OPTION 4-1 ESTIMATED IMPACT ON 'BENEFIT' VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	-3.9	-10.2	16.0	2.0	-16.5	29.1	-6.0	-0.1
Post-tax contribution: Local sales	-4.1	-8.1	0.0	-6.3	0.0	22.1	-4.0	-4.4
No post-tax contribution: Total sales	-8.0	-13.9	23.0	4.4	-22.3	36.1	-9.1	-0.4
No post-tax contribution: Local sales	-8.0	-11.0	0.0	-8.2	0.0	27.8	-7.3	-7.8

Demand for total 'benefit' vehicles is expected to fall by 0.1% to 0.4% depending on the assumed employee contribution. The impact on vehicle segments varies greatly, with small, SUV and upper/large sales expected to increase, while large, medium and light-people mover sales are expected to decrease.

The SUV result is counterintuitive given that the effective own-price of SUVs is expected to rise. This outcome stems from the fact that the estimated auto demand model has a very strong complementarity between small vehicles and SUVs, which causes the demand for SUVs to rise with a fall in small vehicle prices. This may reflect the fact that households make joint purchasing decisions for small vehicles and SUVs.

Demand for locally produced 'benefit' vehicles is estimated to fall by 4.4% to 7.8% depending on the assumed employee contribution. This reflects falls in sales for locally produced large and medium vehicles and SUVs.

Table 21 shows that switching from the current FBT arrangement to Option 4-1 will have a negligible impact on the total sales of all vehicle types, with total sales expected to fall by less than 0.1%. 'Benefit' vehicles account for a larger share of locally produced sales, so the impact on sales of locally produced vehicles is expected to be somewhat larger, with the estimated fall in sales ranging from 1.5% to 2.7%, depending on the assumed employee contribution.

TABLE 21: OPTION 4-1 ESTIMATED IMPACT ON TOTAL VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	-1.5	-2.9	2.2	0.7	-1.6	5.3	-0.5	-0.0
Post-tax contribution: Local sales	-1.6	-2.3	0.0	-2.5	0.0	4.1	-0.7	-1.5
No post-tax contribution: Total sales	-3.0	-4.0	3.2	1.6	-2.1	6.6	-0.8	-0.1
No post-tax contribution: Local sales	-3.1	-3.2	0.0	-3.3	0.0	5.1	-1.2	-2.7

Estimated impact on emissions

Table 22 combines the estimated change in the sales volume with estimates of the average annual volume of emissions for each type of car derived from the MCMS novated lease data to estimate the change in carbon emissions stemming from the introduction of Option 4-1.

TABLE 22: OPTION 4-1 ESTIMATED IMPACT ON CARBON EMISSIONS (TONNES)

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	-9,511	-4,030
No post-tax contribution	-16,882	-6,767

According to these estimates, total emissions would be lower under Option 4-1. In fact, Table 22 suggests that the increase in emissions flowing from a rise in sales of imported small vehicles and SUVs is more than offset by the decrease in emissions flowing from the fall in sales of moderately high emitting locally produced large, medium and SUV sales.

TABLE 23: OPTION 4-1 ESTIMATED REDUCTION IN 'BENEFIT' VEHICLE EMISSIONS

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	-4.3%	-0.7%
No post-tax contribution	-7.7%	-1.2%

Table 23 expresses the reductions as a percentage of total 'benefit' vehicle emissions in 2007. The switch from the current FBT arrangement to Option 4-1 implies a modest reduction in 'benefit' vehicle emissions of 0.7% to 1.2%, depending on the assumed employee contribution.

The switch to Option 4-1 is largely neutral with respect to the impact on the number of vehicles sold. Therefore the reduction in total emissions reflects the net effect of a reduction in sales of high emitting vehicles and an offsetting increase in sales of lower emitting vehicles. When viewed through this lens, the policy has considerably more impact from the standpoint that the average reduction in emissions per substituted vehicle is between 17% and 20% depending on the assumed employee contribution. This is an intuitive result, since

the outgoing less-efficient vehicles emit roughly 5 tonnes per year, while the incoming more-efficient vehicles emit roughly 4 tonnes per year.

3.4.4 SCENARIO 4 – UNDER MCMS’S ASSUMED 2014 ENVIRONMENTAL RATING

Estimated effective price change

MCMS requested an analysis of the impact on vehicle sales in 2014 assuming the current FBT arrangement is replaced by the revenue neutral statutory rates proposed under Option 4-1. The key difference between this and the previous scenario is that MCMS has assumed that by 2014 the GVG star rating of all ‘benefit’ vehicles will rise by 1 star, so that a vehicle that had a 3 star rating in 2008 will have a 4 star rating in 2014.

Table 24 reports the estimated impact on effective vehicle prices in shifting from the current FBT statutory rate system to that proposed for Option 4-2 under MCMS’s assumed 2014 GVG star rating. The average fall in effective price is estimated to be 5.9% to 8.4% depending on assumed employee contribution.

TABLE 24: OPTION 4-2 INCREASE IN 2014 EFFECTIVE VEHICLE PRICE OVER CURRENT FBT ARRANGEMENT (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Commercial	Total
Post-tax contribution: Total sales	-6.8	-6.6	-6.3	-5.0	-5.9	-11.7	-3.3	-5.9
Post-tax contribution: Local sales	-6.9	-6.5	0.0	-2.2	0.0	-11.7	-3.3	-6.0
No post-tax contribution: Total sales	-9.5	-8.8	-9.2	-7.3	-8.9	-16.0	-5.0	-8.4
No post-tax contribution: Local sales	-9.6	-8.8	0.0	-3.2	0.0	-16.0	-5.0	-8.4

Estimated impact on auto industry demand

The auto demand model predicts relatively small changes in value shares of the different ‘benefit’ vehicle segments for this scenario. Therefore the main driver of changes in sales is changes in effective prices. Combining these components of the analysis implies the impacts on ‘benefit’ vehicle sales reported in Table 25.

Demand for total ‘benefit’ vehicles is expected to rise by 6.2% to 9.2% depending on assumed employee contribution. The impact on different vehicle segments varies, with large, medium and upper/large sales expected to increase significantly, while small, SUV and commercial sales are expected to rise modestly.

Similarly, the demand for all locally produced ‘benefit’ vehicles is estimated to rise by 10.4% to 13.4 % depending on assumed employee contribution. This reflects strong growth in large and medium vehicle sales.

TABLE 25: OPTION 4-2 ESTIMATED IMPACT ON 2014 'BENEFIT' VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution: Total sales	12.0	12.9	3.5	1.7	-10.5	49.7	3.4	6.2
Post-tax contribution: Local sales	11.9	12.2	0.0	0.8	0.0	38.4	3.4	10.4
No post-tax contribution: Total sales	15.3	15.6	6.8	4.2	-7.5	57.2	5.2	9.2
No post-tax contribution: Local sales	15.3	15.1	0.0	0.3	0.0	45.3	5.2	13.4

Table 26 shows that aggregate demand for vehicles is expected to rise by 1.3% to 1.9% depending on assumed employee contribution. The policy switch is expected to have a significant impact on total sales of locally produced large vehicles, with local large segments sales expected to rise by 3.5% to 4.6%.

TABLE 26: OPTION 4-2 ESTIMATED IMPACT ON 2014 TOTAL VEHICLE SALES (PERCENT)

Employee contribution assumption	Large	Medium	Small	SUV	Light/ People Mover	Upper large/ Sport	Comm-ercial	Total
Post-tax contribution: Total sales	4.5	3.7	0.5	0.6	-1.0	9.0	0.3	1.3
Post-tax contribution: Local sales	4.6	3.5	0.0	0.3	0.0	7.1	0.6	3.5
No post-tax contribution: Total sales	5.8	4.5	0.9	1.5	-0.7	10.4	0.4	1.9
No post-tax contribution: Local sales	5.9	4.3	0.0	0.1	0.0	8.3	0.9	4.6

To implement this scenario, an assumption had to be made about the implied reduction in emissions per vehicle by 2014. The MCMS data sample suggests that a one star improvement implies a 20% reduction in average CO2 emissions.

Estimated impact on emissions

The estimated impact on carbon emissions under Option 4-2 with the assumed 2014 star rating is provided in Table 27. These estimates combines the change in the sales volumes with the 2014 adjusted average annual volume of emissions for each type of car derived from MCMS novated lease data.

TABLE 27: OPTION 4-2 ESTIMATED IMPACT ON 2014 CARBON EMISSIONS (TONNES)

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	-27,202	-86,477
No post-tax contribution	-22,062	-73,108

TABLE 28: OPTION 4-2 ESTIMATED REDUCTION IN 2014 'BENEFIT' VEHICLE EMISSIONS

Employee contribution assumption	Local sales	Total sales
Post-tax contribution	-12.3%	-15.1%
No post-tax contribution	-10.0%	-12.8%

As expected the scenario implies a significant reduction in 'benefit' vehicle emissions. These reductions are reported in Table 28 as a percentage of total 2007 'benefit' vehicle emissions. Total 'benefit' vehicle emissions are expected to fall by 12.8% to 15.1%, depending on the assumed employee contribution. In all cases the reduction in emissions of total 'benefit' vehicles is less than 20% because of the expected increase in sales.

4. REFERENCES

Australian Government, Budget 2008-09, Budget paper 1, Statement 5: Revenue (www.budget.gov.au).

Australian Taxation Office, Taxation Statistics 2005-06, Fringe Benefits Tax (www.ato.gov.au)

Warren, N. (2006) Fringe benefit tax design: Decision time, The Institute of Chartered Accountants in Australia, February 2006.



AUSTRALIAN AUTOMOBILE DEALERS ASSOCIATION

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Mr Anthony Podesta
Executive Director
McMillan Shakespeare Limited
Locked Bag 18
Collins Street East
MELBOURNE VIC 8003

Dear Mr Podesta

I write to advise that the Directors of AADA met on 16 April and considered the McMillan Shakespeare presentation in relation to "Fringe Benefit Tax and Company (Benefit) Motor Vehicles provided to Employees.

In the result, I am pleased to advise that the AADA Board endorsed the "Star FBT Option" model as outlined in that presentation. AADA believes that the model, which links FBT to the environmental star rating of a vehicle, is innovative and will assist in generating long-term sustainable demand for locally produced vehicles. Importantly, the model successfully achieves a balance between environmental concerns on the one hand and the need to support the local automotive industry on the other. AADA emphasises, however, the need for an appropriate transition period in respect of such a change to the current FBT arrangements.

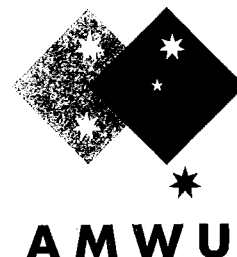
As well, AADA offers its strong support for the continuation of the FBT concessions applying to salary sacrificed leased motor vehicles. Given the large number of new vehicles purchased that are facilitated by the FBT concession, it is in the interest of dealers that the FBT concessions continue, albeit linked in the future to better environmental outcomes.

I thank you for bringing this model to AADA's attention.

Yours sincerely

MICHAEL DELANEY
Executive Director

4 May 2009



Mr Anthony Podesta
Executive Director
McMillan Shakespeare Limited
Locked Bag 18
Collins Street East
MELBOURNE VIC 8003

Date 1 May 2009

Dear Mr Podesta

I write to offer my support for McMillan Shakespeare's submission to the Henry Review of Taxation.

The Australian Manufacturing Workers Union (AMWU) Vehicle Division supports open and reasonable contributions to the public policy debate on issues that are relevant to our members and their interests. Chief among those interests is the long term viability and sustainability of the Australian motor vehicle industry.

Having examined McMillan Shakespeare's submission to the Henry Review, I am convinced that should the government be of a mind to alter the current FBT arrangements, the "Star FBT Option" for linking FBT to the environmental star rating of the vehicle is innovative and will help to generate long term sustainable demand for locally produced vehicles. As such, this proposal successfully achieves a balance between environmental concerns on the one hand, and the need to protect local automotive industry jobs on the other.

The "Star FBT Option" also aligns with the federal government's initiatives for "A new car plan for a green future" by delivering reductions on carbon emissions of company cars by up to 20% or 1 tonne per motor vehicle.

I would also like to indicate the AMWU Vehicle Division's strong support for the continuation of the FBT concessions applying to company and benefit motor vehicles. Given the large number of new vehicle purchases that are facilitated by the FBT concession, it is in the interest of workers employed in the local industry for the FBT concessions to continue albeit linked in the future to better environmental outcomes.

This is the sort of taxation, economic and social policy analysis that is needed if Australia is serious about a maintaining a viable motor vehicle industry, as well as dealing with the challenges presented by climate change.

Thank you for providing me with a copy of your submission. Congratulations on McMillan Shakespeare's contribution to this important issue. I wish it every success.

Yours sincerely


Ian Jones
National Secretary
AMWU Vehicle Division

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15 September 2009

Mr Anthony Podesta
Executive Director
McMillan Shakespeare Ltd
Locked Bag 18
Collins Street East
Melbourne VIC 8003



Dear Mr Podesta

I am writing to offer my support for McMillan Shakespeare's submission to the Henry Review of taxation.

The Committee for Melbourne is working with employers to help them encourage their staff to use sustainable modes of transport to commute to work in the CBD. As part of that effort, we have been working with a new network of employers, Access Melbourne, to help employers develop workplace travel plans.

As part of the research to develop such plans, employers have told us that the current taxation system presents a major barrier to them encouraging staff to use sustainable modes of transport, such as public transport, walking and cycling. At the same time, employers have expressed their wish to tackle current FBT arrangements for work vehicles, but I am mindful of the negative impact that changes may have upon staff recruitment.

The Committee supports McMillan Shakespeare's proposal to replace the existing formula for calculating FBT with a system based on the environmental rating of the vehicle using the government's Green Vehicle Guide.

The star option put forward presents an alternative arrangement which will have a real impact on the carbon emissions of company cars, and also present a viable future pathway for the Australian car manufacturing industry.

This proposal is in line with the Committee's recent Climate Change Taskforce which recommended reform of federal tax arrangements to remove incentives that maximise car use and discourage public transport use, and in particular reform of current FBT incentives.

Thank you for providing me with a copy of your submission, and we wish you well in your endeavours.

Yours sincerely

Susan Vale
Policy Director



Submission to the Review of Australia's Future Tax System

Comments on Questions from Chapter 4 of the
Consultation Paper
Not-for-Profit Organisations

The Salvation Army, May 2009

About The Salvation Army in Australia

The Salvation Army is an evangelical branch of the universal Christian Church. Its message is based on the Bible and its ministry motivated by love for God. This mission is both spiritual and practical, encompassing the preaching of the gospel of Jesus Christ and alleviating human suffering and distress without discrimination.

The Salvation Army is raised up by God for the work of:

- Transforming lives
- Caring for people
- Making disciples
- Reforming society

This is manifested in the various expressions of Salvation Army work.

The Salvation Army values:

- Human dignity We affirm the worth and capacity of all people
- Justice We promote healthy and whole relationships, and good society
- Hope We work for reconciliation, healing and transformation for all people and creation
- Compassion We feel compelled to stand with and do something about another's suffering
- Community We build community and meet with God in our encounter with others

The Salvation Army has its international headquarters in London. The Salvation Army in Australia has been operating in Australia since 1880. For the business purposes of its Australia Southern Territory, it is incorporated by the following Acts and Ordinances of Parliament:

- The Salvation Army (New South Wales) Property Trust Act 1929
- The Salvation Army (Queensland) Property Trust Act 1930
- The Salvation Army (Victoria) Property Trust Act 1930
- The Salvation Army (Tasmania) Property Trust Act 1930
- The Salvation Army (South Australia) Property Trust Act 1931
- The Salvation Army (Western Australia) Property Trust Act 1931
- The Salvation Army (Australian Capital Territory) Ordinance 1934
- The Salvation Army (Northern Territory) Property Trust Ordinance 1976

The type of services and welfare, which The Salvation Army provides to the local community, include the following:

- Family Crisis Centres
- Homeless Shelter

- Aged Care Centres
- Safe-housing for victims of violence
- Bridge Programs (alcohol, drug and gambling abuse programs)
- Crisis Telephoning Services
- Survivors of Suicide Groups
- Crisis Counselling (including grief counselling)
- Youth Crisis Centres
- Emergency Services
- Crisis Accommodation Centres
- Family Counselling
- Marriage Enrichment
- Child Care
- Disaster Relief (the Army provides direct relief or alleviates the distresses caused by natural and man-made catastrophes)
- Migrant Services
- Court and Prison Services
- Youth Support Services
- Youth drop-in Centres
- Intellectual Disability Services
- Recreation programs for the elderly
- Salvos Stores (donated goods available for the public)
- Employment Plus (placing long term unemployed into jobs)
- Worship and other services provided by The Salvation Army throughout Australia as a part of the universal Christian Church
- Services provided by Red Shield Defence Services

In any given week, The Salvation Army provides:

- more than 5,000 beds for the homeless
- more than 100,000 meals provided
- between 5,000 and 8,000 food vouchers
- more than 500 people addicted to drugs, alcohol or gambling with assistance
- several thousand people with counselling
- more than 500 victims of abuse with refuge
- more than 1,000 people with jobs through Employment Plus
- around 3,000 elderly with aged care services
- more than 1,000 people in courts and prisons with chaplain support
- Family Tracing services which locate 40 missing family members.

Introduction

The Salvation Army welcomes the opportunity to contribute to the review of Australia's future tax system, in relation to its impact on the not-for-profit sector.

This submission focuses on the two consultation questions raised as part of the Consultation Paper (Section 7) for this review:

1. What is the appropriate tax treatment for NFP organisations, including compliance obligations?
2. Given the impact of tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

These questions are addressed below, with appropriate comments and recommendations made in relation to each.

What is the appropriate tax treatment for NFP organisations, including compliance obligations?

There are a number of taxes that affect NFP organisations and these taxes are levied by either State Governments or the Federal Government.

One of the major difficulties NFP organisations face when addressing taxation obligations are the definitional differences each level of Government uses when identifying how a tax is to be applied to a NFP organisation.

The Salvation Army recommends that a standardised definitional approach to NFP organisations is developed and implemented across all Government levels to enable NFP organisations to more readily and easily understand and comply with relevant taxation laws. The Salvation Army is aware this topic of definitional standardisation of the NFP sector has been considered in separate reviews/committees however The Salvation Army believes this is an extremely important area affecting NFP organisations (in particular charitable organisations) and must be resolved collectively by the relevant Australian governmental levels.

The Salvation Army will limit further comments in this submission to Federal Government taxation matters and comment on three major taxation areas: income tax, fringe benefits tax and Goods and Services Tax.

Income Tax

The Salvation Army is recognised and endorsed by the Australian Taxation Office as charitable. Accordingly The Salvation Army across Australia is currently exempt from income tax.

The Salvation Army recommends the current income tax exemption laws are maintained and continue to operate on an organisation wide basis.

The current income tax laws enable The Salvation Army to undertake activities that benefit the people of Australia in a wide and encompassing manner without the need to incur additional compliance costs. This is due to all the income received by The Salvation Army for the activities it undertakes being automatically exempt from income tax. The Salvation Army believes it is correct to exempt NFP organisations (like The Salvation Army) from income tax as all activities The Salvation Army undertakes are for the furtherance of the organisation's charitable purposes and should not be treated differently for income tax purposes.

The Salvation Army is aware that there are different views on the taxation methods of NFP organisations and one such view is to impose a method of taxing NFP organisations based on the activities the NFP organisation undertakes. The Salvation Army does not recommend an implementation of an 'activity based' income tax on NFP organisations. The Salvation Army believes such an approach would lead to increased interpretation disputes, compliance costs and confusion for NFP organisations and ultimately result in no real benefit to the Australian public.

As The Salvation Army is endorsed by the Australian Taxation Office as being charitable and income tax exempt, The Salvation Army is also entitled to seek refunds of franking credits on any franked dividends it receives. The Salvation Army recommends that the entitlement for refunds of franking credits on franked dividends is continued in the future for charitable organisations as these refunds form part of an important income stream to charitable organisations and are integral to the concept of a charitable organisation being exempt from income tax.

Fringe Benefits Tax

The Salvation Army currently is entitled to a mixture of rebatable and exempt fringe benefits for employees up to the relevant \$30,000 grossed up cap limits.

The Salvation Army is reliant on the fringe benefits tax exemption for public benevolent institution employees to enable these employees to receive an after tax salary amount that The Salvation Army could not otherwise afford to pay.

For an employee earning \$35,000, the fringe benefit tax exemption allows this employee to receive an additional \$2,918 per annum. This represents a significant wage cost saving to The Salvation Army. If this fringe benefit exemption were to be removed, The Salvation Army would need to either increase the employee's gross wage to compensate the employee with an equivalent after tax wage, or would be

forced to consider reallocating resources and determine which programmes can continue to operate given the government imposed revised cost structure resultant from losing access to the fringe benefit exemption.

The Salvation Army also notes the \$30,000 cap for both rebateable and public benevolent institutions has not been adjusted or indexed since the cap was introduced in the 2001 fringe benefits tax year. The Salvation Army notes that as a result of the lack of indexation of the cap, the benefit is decreasing over time while the overall costs of employment continue to increase. As the marginal income tax rates have decreased in recent years, the benefit of the fixed capped amount has also been eroded. The Salvation Army recommends that the \$30,000 cap be increased and, at a minimum, the increase should be equal to CPI increases each year. This should ideally be backdated.

Goods and Services Tax

The Salvation Army is registered for GST and is entitled to access the various GST concessions within the GST law available to charitable institutions. One concession that is available to charitable institutions is contained in Section 38-250 of *A New Tax System (Goods and Services Tax) Act 1999*. This section enables supplies made by a charitable institution that would otherwise be a 'taxable supply' or an 'input taxed' supply to be GST-free when certain circumstances are satisfied.

This concession is of significant benefit to The Salvation Army, however, due to the nature of Section 38-250, the section applies in a compulsory manner for each and every transaction a charitable institution enters into. Unfortunately this means that consistent compliance can be difficult given the range of supplies an organisation such as The Salvation Army makes.

The Salvation Army recommends Section 38-250 is modified to enable a charitable institution the choice as to whether or not the section applies to a transaction (or group of similar transaction types).

Given the impact of tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

The Salvation Army is concerned with the notion of the provision of direct funding as a replacement to the current taxation concessions being accessed.

The Salvation Army does not believe it would be possible to adequately perform the current services it provides if it were required to petition/apply to Governments for funding that is intended to compensate The Salvation Army for forgoing taxation concessions (of any kind). The Salvation Army believes such a system would be inefficient and result in increased administration costs and not be of any overall benefit to the Australian public.

It is often suggested that tax concessions provide Not-For-Profit organisations with a competitive advantage over For-profit organisations. If Not-For-Profit organisations do derive any competitive advantage, it is always applied to the benefit of the service recipients who are then able to be offered an enhanced or expanded range of services.

The Salvation Army recommends that if any changes are to be made to the current tax concessions, their method of delivery/access or replacement funding, appropriate public consultation must be undertaken after detailed information is publicly released for organisations to review.

Conclusion

The Salvation Army recognises the enormity of the review being undertaken by the Review Panel and is more than happy to provide further information via public forums should the Review Panel hold consultation meetings in relation to these matters.

Submission to the Review of Australia's Future Tax System

March 2009



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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

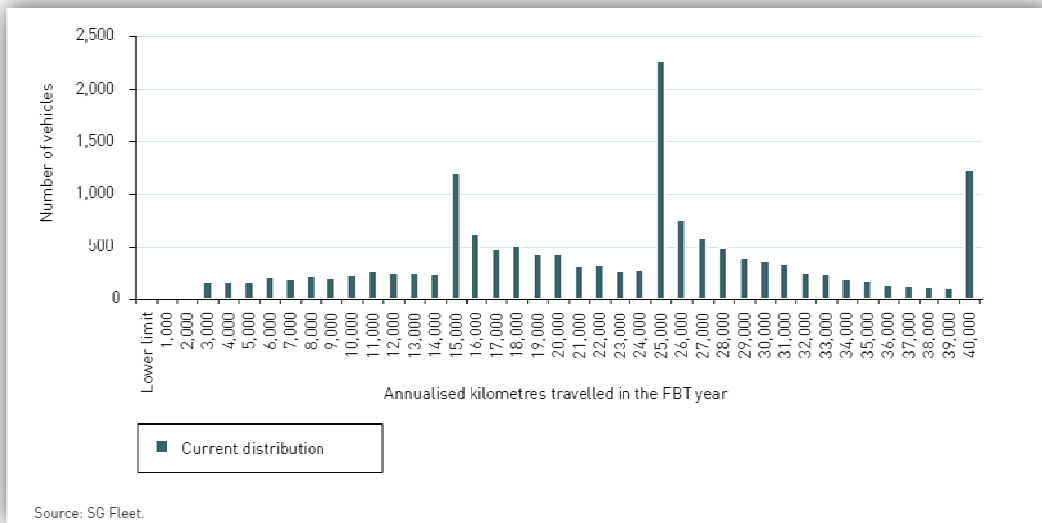
THE STATUTORY FORMULA

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

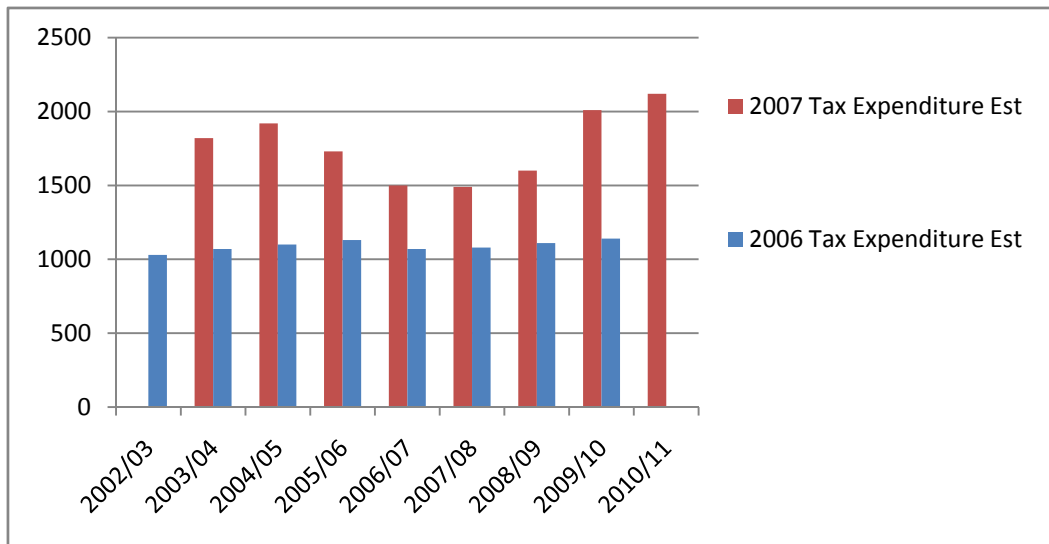
Other economic affairs - Other economic affairs, nec (\$m)							
2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
1820	1920	1730	1500	1490	1600	2010	2120
<i>Tax expenditure type:</i>		Discounted valuation			<i>2006 TES code:</i>		D24
<i>Commencement date:</i>		1986					
<i>Expiry date:</i>							
<i>Legislative reference:</i>		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.

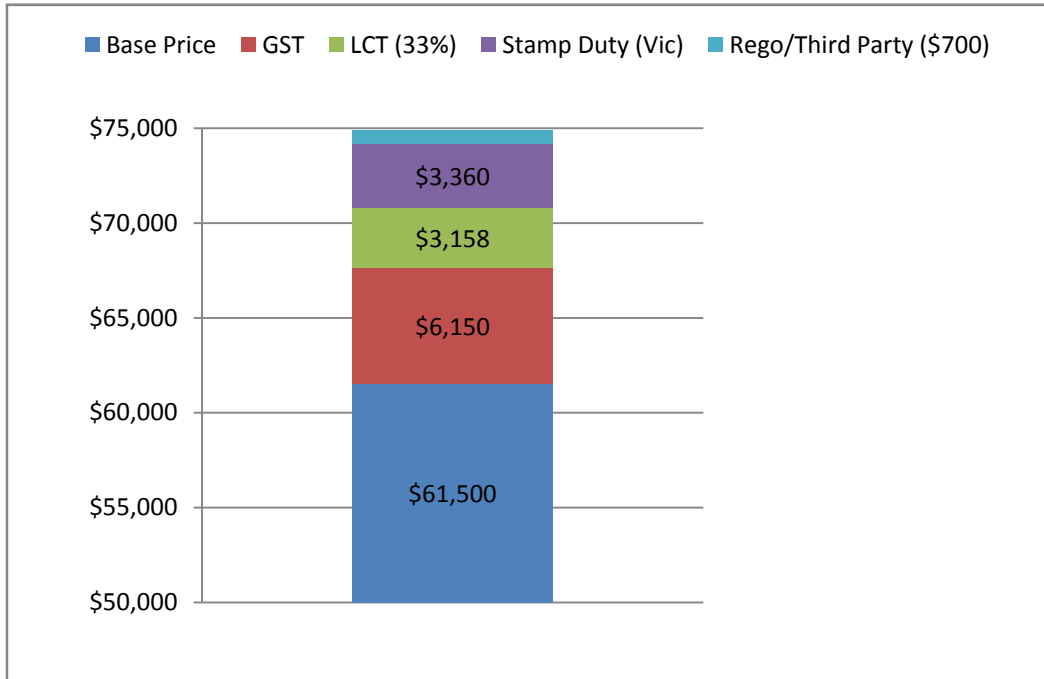
No other product, including private aircraft, jewellery or yachts are defined by the taxation system as luxury items. Similarly, any international example of a 'luxury' tax appear to have been replaced by more efficient methods of taxation.

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.

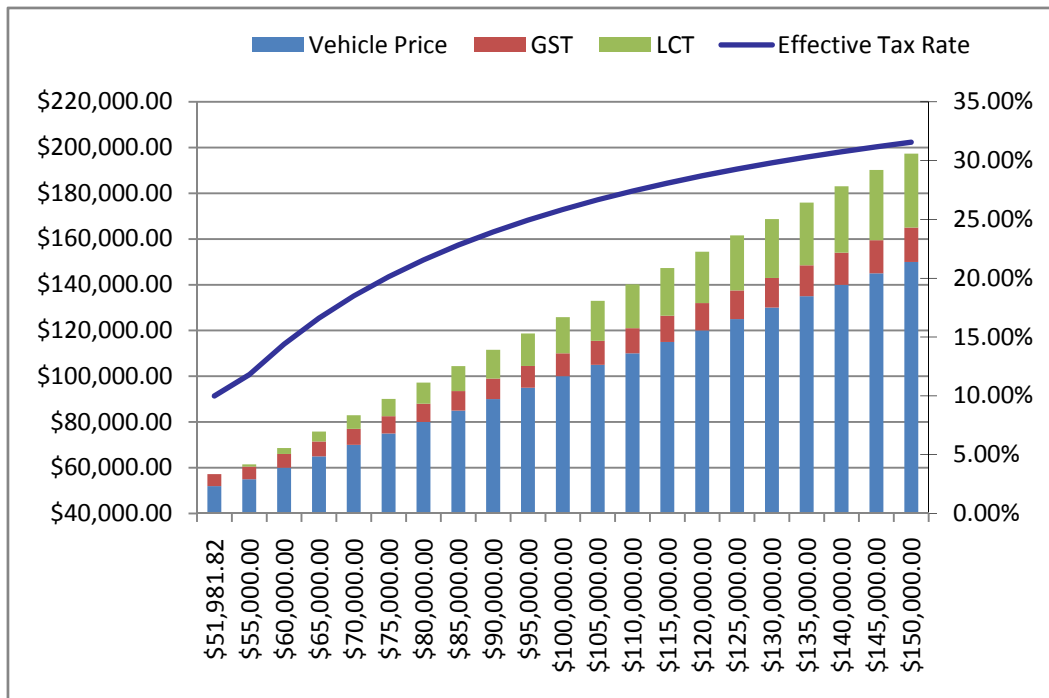
The Chart below shows the impact of the multiple taxation arrangements on a motor vehicle with a base price of \$61,500. In addition to the taxes shown below, motor vehicles can also incur FBT, fuel excise and stamp duty on insurance charges.

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.

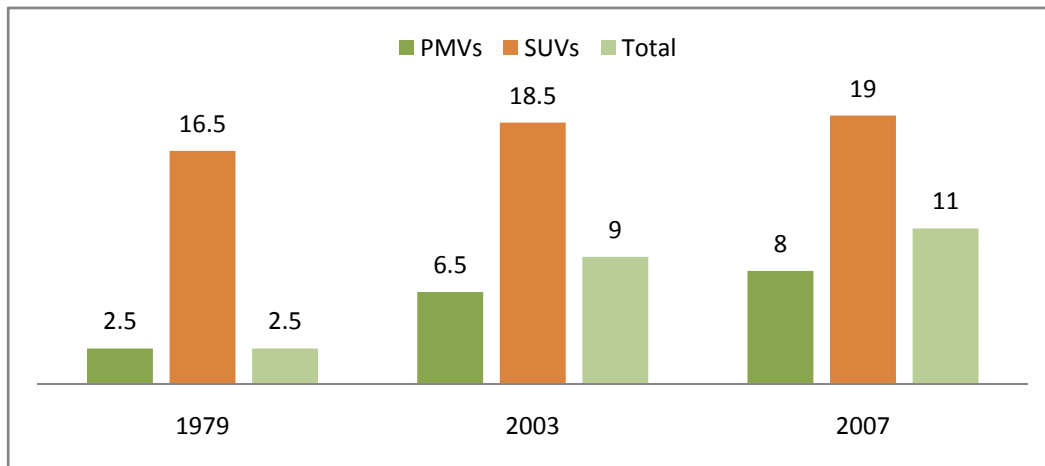
A number of vehicle importers are now planning to replace vehicle models currently sold in Australia with an equivalent diesel powered vehicle, with fuel consumption of less than 7 litres/100km, which has higher carbon emissions than the model currently being sold in Australia.

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.

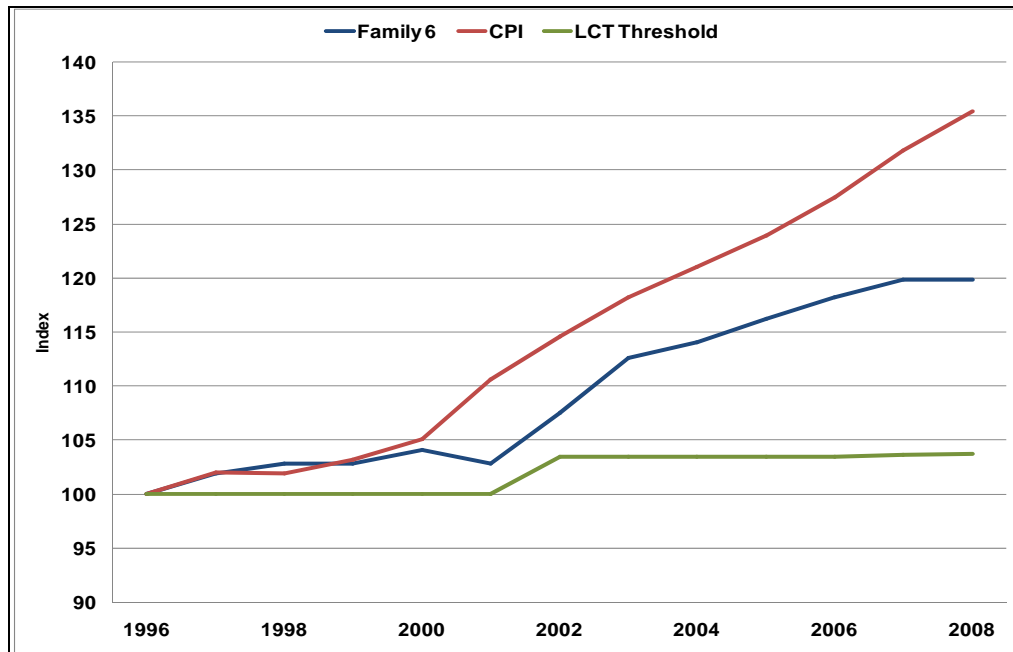
The CPI-MV measures change in the price of motor vehicles over time however, adjustments are made to the index to remove the impact of 'quality' improvements in vehicles that affect motoring performance, economy, comfort level, safety or durability.

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

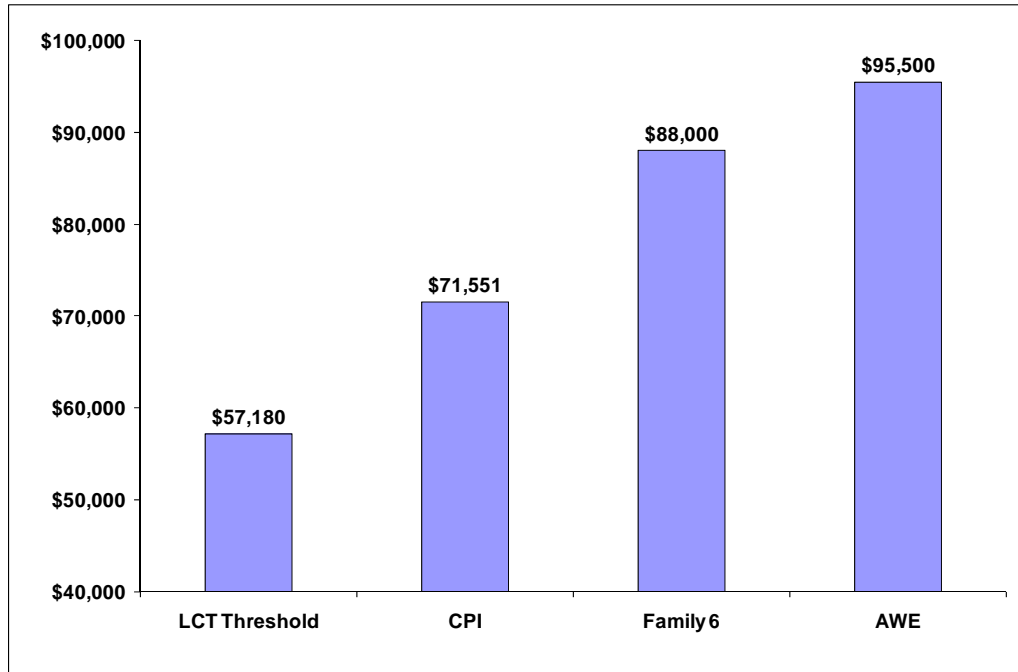


Source: Australian Automotive Intelligence

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).

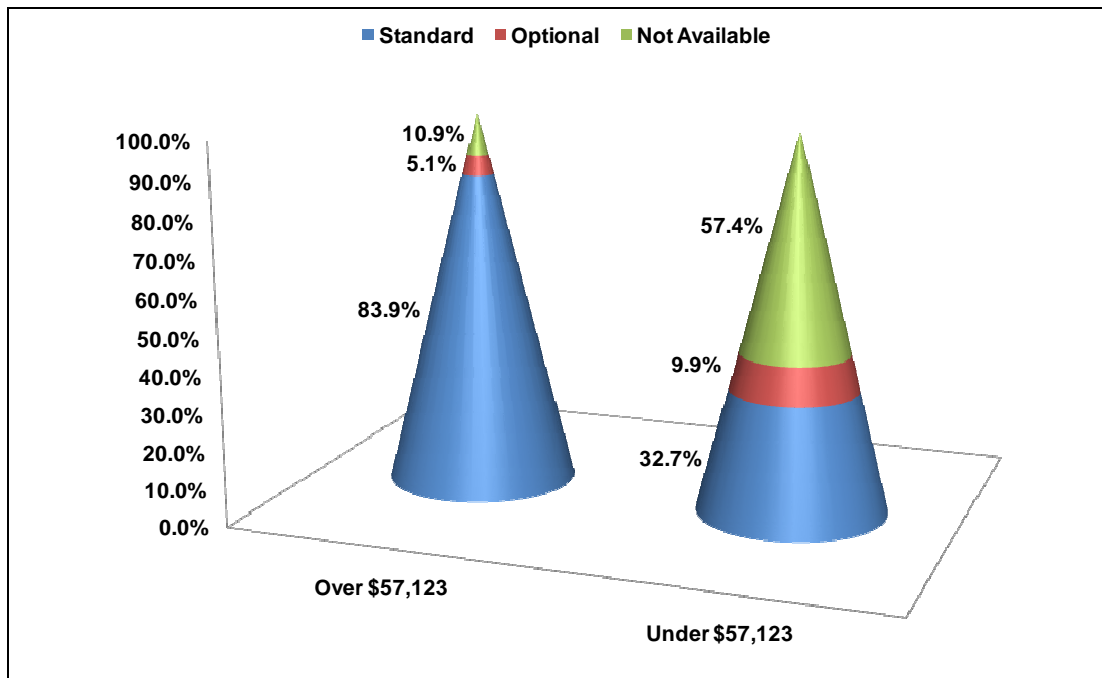
IMPACT ON SAFETY AND THE ENVIRONMENT

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.