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Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Email: bettertax@treasury.gov.au

Dear Sir/Madam

**AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION LTD (AADA)**
**TAX WHITE PAPER (TWP) SUBMISSION**

AADA welcomes the release of the Tax White Paper by the Treasurer, the Hon Joe Hockey MP on 30 March 2015 inviting submissions on how we can create a better tax system that delivers taxes that are lower, simpler and fairer. We note that tax reform is a key part of the Government's policy agenda to build jobs, growth and opportunity.

AADA is the peak industry body representing franchised new car dealers in Australia. There are over 1500 new car dealers in Australia that operate something in the order of 2600 new vehicle outlets. Dealerships range from family-owned small businesses to larger businesses and two public companies operating in the regions, metropolitan areas and across the States and Territories. The authorised dealer network generates revenue in excess of $72 billion, employs in excess of 66,000 people, pays wages in excess of $5.6 billion annually and has invested around $17 billion in facilities. Our members pay, collect and remit billions of dollars in taxation revenue to the Government each financial year.

In 2014 Australian new car sales were just over 1.1 million in one of the most open and competitive markets in the world with more than 67 brands and 350 models competing for market share. More than 90 per cent of vehicles were imported from many countries and regions in the world with Asian sourced vehicles accounting for around 66 per cent. Manufacturing of motor vehicles in Australia will cease in 2017.

The purchase of a motor vehicle attracts a range of taxes and charges including customs duty, registration fees and insurance, stamp duty, goods and services tax (GST), fringe benefits tax (FBT), fuel excise and the luxury car tax (LCT). The LCT is an additional tax on a consumer and makes a significant contribution to government revenue. In 2013-14 the Australian Government raised $476 million from the LCT and it is estimated to raise $500 million in 2014-15. Revenue from LCT is around 0.1 per cent of total Commonwealth government revenue.

This submission and previous submissions from the automotive sector calls on the Government to abolish the LCT the policy rationale for which no longer exists and to our knowledge is the only "luxury" tax of its kind in the developed world. While a range of words such as "Tarago Tax" have been used to describe the LCT it is best summed up in a single word used by a former Secretary to the Treasury, Dr Ken Henry AC as "absurd".

**Challenges of Tax Reform**

The biggest challenge facing the Treasurer and Government is managing the politics of tax reform. It has been said by a leading tax scholar that tax is politics with a dollar sign in front and invariably political manoeuvring over the GST, and hip pocket nerve issues including superannuation will hinder the process of genuine reform. We understand the politics of tax reform and if the Commonwealth and the States have a genuine appetite for meaningful economic and tax reform then the issues for consideration in the Tax and Federation White Papers must be considered together in a meaningful way.

A key issue for reform between the Commonwealth and the States in the Federation White Paper is fiscal imbalance across the federation - the degree of vertical fiscal imbalance (VFI) and horizontal fiscal equalisation (HFE). VFI is referred to the mismatch between the expenditure responsibilities of the States and Territories relative to the revenue raised which makes them reliant on Commonwealth funding to finance their activities. HFE is the mechanism to reduce fiscal disparities between the States and Territories to allow for an equivalent level of services to all Australians regardless of State or Territory.

Fiscal imbalance across the federation and tax reform are joined at the hip and AADA submits that this message needs to be conveyed to the community at large so the community can understand the need for reform.

*Goods and Services Tax*

We note Australian tax revenue is raised from over 100 different taxes but the majority of revenue is collected from just a few taxes – 81 per cent mainly from individuals and corporates. GST accounts for 12 per cent of tax revenue and State and Territory Governments receive 45 per cent of their revenue from the Federal Government including all GST revenue.

Under the *Intergovernmental Agreement* all GST revenue is distributed to the States and Territories and it is unlikely the base and rate of GST will change unless there is unanimous agreement between all the States and Territories. Therein lies a challenge for all Governments including the complexity of the number of taxes levied by three levels of government which raise very little revenue, and are difficult to administer because of different bases and rates.

AADA is aware of the CPA Australia report which examined the impact of GST changes and clearly demonstrates the benefits to Australia's GDP and the need to package changes to the GST in order to sell the benefits of reform. The Business Council of Australia estimates that GST exemptions cost more than $20 billion a year in foregone GST revenue, compared with GST revenue of $50 billion per year.

AADA submits that the Commonwealth and State Governments have a duty to the Australian public to present a range of options for consideration through modelling which shows the effects of a broadening of the base and increasing the rate of GST.

*Individuals*

Personal income tax is the single largest source of Commonwealth Government revenue accounting for around a half of tax receipts. Individuals' income tax thresholds are not indexed to inflation and results in bracket creep or fiscal drag. This means that individuals will face higher average tax rates even if their income has only increased by inflation.

AADA submits that the Government should not rely on the additional revenue from individual taxpayers generated by bracket creep to reduce the budget deficit and changes need to be made to rates and thresholds. This excessive burden on individual taxpayers is not sustainable and bracket creep mitigation could be funded from other reform measures and structural changes to Government spending.

*Company tax*

Australia's corporate tax rate of 30 per cent is higher than the OECD average and many countries in the Asia-Pacific region (average around 23 per cent). We recognise that a lowering of the corporate tax rate could increase Australia's attractiveness as a place to do business with consequential benefits to the community but at the same time would widen the gap between the corporate rate and the highest marginal tax rate. In lowering the corporate tax rate there are many factors to consider including profit shifting but Australia needs to respond to a global perception that the corporate tax rate of 30 per cent is too high at a time when many countries are lowering the rate.

*Indirect taxes*

The Australian Government collects a range of indirect taxes levied on specified goods and services including fuel taxes, alcohol taxes, tobacco tax, the LCT, agricultural levies and tariffs. These narrow based or selective taxes should according to the Henry tax review be imposed for one of three purposes:

- to improve market or social outcomes by addressing spillover costs and benefits;
- to help counteract self-control problems (in the special case of alcohol); and
- to improve market efficiency through appropriate price signals.

The Report at p.53 stated "Revenue should be a by-product of such taxes, not the reason for them." It also noted the LCT discriminates against a particular group of people because of their tastes. It is a complex and ineffective way of distributing income from rich to poor.

The Report on Australia's Future Tax System in 2009 made 138 recommendations including "Recommendation 80: The luxury car tax should be abolished."

Since the Henry tax review the Australian automotive sector has undergone significant change with manufacturing of motor vehicles in this country expected to cease in 2017. Most if not all motor vehicles will be imported into Australia once manufacturing ceases and to selectively target and impose an additional tax an imported motor vehicle to the exclusion of other "luxury" goods is at odds with Australia's trade liberalisation policies.

**Luxury Car Tax**

The LCT was introduced from 1 July 2000 as part of the GST tax reform package which saw the abolition of wholesale sales tax (WST). Under the WST luxury cars were taxed at a high rate together with other consumer goods such as furs, jewellery and electronics. These other goods became subject to the GST (10%) while luxury cars became subject to the GST and LCT at the then rate of 25 per cent. The Rudd government increased the rate to 33 per cent in 2008.

LCT applies at to cars sold or imported into Australia where the value of the car exceeds a GST-inclusive threshold. Some cars are exempt from tax including non-passenger commercial vehicles, most second hand cars, motor homes, campervans and emergency vehicles. The LCT rate of 33 per cent applies to the GST-exclusive value of the car (including accessories) above the LCT threshold. For the 2014-15 financial year the threshold is $61,884 for regular cars and $75,375 for fuel efficient vehicle. Revenue raised in 2013-14 was $476 million and in 2014-15 is estimated to be $500 million.

*Policy rationale for retention no longer relevant*

The explanatory memorandum accompanying the bill introducing the LCT and replacing the 45 per cent WST on luxury vehicles stated "[it] will ensure that, following the introduction of the goods and services tax (GST), the value of luxury cars will fall in price as the same amount as a car just below the luxury car threshold." (LCT threshold for 1998-1999 was $55,134).

The Senate Standing Committee on Economics examined the bill in 2008 and noted the original 1986 WST "appears to have been a protectionist measure, designed to increase the price of European imports, while the 2000 LCT was introduced to ensure the introduction of GST did not result in a sudden reduction in the price of luxury vehicles, apparently because this might erode support for the GST". Moreover, VACC in its submission to the committee noted "The European Union, and some importers have criticised the LCT as a disguised form of protection for the Australian car industry. According to the European Commission, 90 per cent of vehicles subject to the LCT are imported and 50 per cent are from Europe."

Australia's LCT is unique in the global tax landscape, penalises a consumer on a discretionary purchase of a motor vehicle, does not apply to other "luxury" goods, and continues to exist on the statute books and Budget line as a major source of Commonwealth revenue despite the Henry Tax Review recommendation that it be abolished. With the impending cessation of motor vehicle manufacturing in Australia by General Motors, Ford and Toyota the LCT is an enigma and is completely at odds with Australia's trade liberalisation policies including Free Trade Agreements to remove barriers to trade for imports. The LCT has often been referred as a thinly disguised tariff barrier.

The tax policy objective of the LCT no longer exists, it targets a single good, and is an additional tax borne by a consumer on a "luxury" car. If the Government's policy objective is to tax luxury items, then a luxury tax should be imposed on other items including antiques, paintings, yachts, furs, jewellery including diamonds and watches, aircraft, holiday homes and luxury homes.

*Tax principles assessment of LCT*

A review of a tax should be conducted against accepted principles of tax evaluation and design:

- equity
- efficiency
- simplicity
- sustainability
- policy consistency

There is no definition of *equity* but a characteristic of a tax is that it should be fair in the distribution of the tax burden. The Henry Tax Review noted that taxes on luxury goods violate the principle of horizontal equity and wealthy people with modest tastes pay less than wealthy people with a preference for luxury goods. The LCT is selective and falls on people with a preference for more expensive cars but not on those with a preference for other items such as private yachts, antique clocks, diamonds and paintings.

The Henry tax review also identified the flaw of luxury taxes when considering vertical equity. The review noted very few luxury goods are the preserve of the wealthy as the LCT is imposed on people of average means who have a preference for relatively expensive cars and as an example pointed out that many people feel a small sports car is luxurious at $60,000 but a 7 seater minivan is not luxurious at the same price.

*Efficiency* in the tax discussion paper is the economy in tax collection so as to have the lowest possible cost over and above the revenue raised. At the time of introduction of the LCT forecast administrative costs to the ATO were estimated at $1.45 million per year compared to revenue of $210 million in 2002-03. This does not include the administrative burden on businesses.

*Simplicity* means that the tax is easy to understand and simple to comply with relative to other taxes. Recent tax decisions in the Federal court have highlighted the complexity of administration of GST and LCT in determining the cost of a motor vehicle, and determination and timing of GST liability.

The Henry tax review referred to *sustainability* of a tax system as having the flexibility to allow the Government to respond to changing revenue needs, and *consistency* of the tax and transfer system to raise revenue and provide assistance to those in need.

The policy objective the Government sought to achieve with the introduction of the LCT has well and truly passed its use by date and in terms of principles the Henry tax review stated:

"Luxury taxes should not be used to raise revenue. They are inefficient because of their narrow tax base. Taxing luxury goods is also an ineffective and arbitrary means of redistributing economic resources."

*Trade liberalisation*

An additional "luxury" tax paid by a consumer on an imported motor vehicle is at odds with Australia's trade liberalisation policies. AADA submits the LCT as a thinly disguised tariff has no further role as a tax policy instrument in protecting the local manufacturing of motor vehicles which is to cease in 2017.

*LCT thresholds*

AADA submits the Government could consider transition arrangements to abolish the LCT to coincide with the cessation of manufacturing in 2017. This could include raising the LCT thresholds to a figure in excess of $100,000 where the price inelasticity of demand is close to zero.

**Conclusion**

AADA submits the LCT is a discriminatory tax on an Australian consumer, as a tax policy instrument is no longer relevant, has passed its use by date and should be abolished.

If you require further information please contact Policy Director, Michael Deed email mdeed@aada.asn.au or myself email ptessier@aada.asn.au

Yours faithfully

Patrick Tessier
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