# What now for environmental sustainability? Government fails to link the Australian car FBT concession to vehicle emissions

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### **Abstract**

Australia's Fringe Benefits Tax (FBT) regime is not aligned with environmental policy objectives of reducing greenhouse gas emissions from road transport. Unfortunately, the reform announced by the Australian Government on 10 May 2011 to remove the incentive for people driving excess kilometres to reduce tax liability is unlikely to significantly cut road emissions. This is because the reform fails to address other behavioural effects harmful to the environment, that is, the concession will continue to increase the total number of vehicles acquired, and distort employees' choice of vehicle towards larger, more carbon emitting vehicles.

To achieve a significant reduction in road transport emissions will require improving the fuel efficiency of conventional vehicles as well as a gradual transition from fossil fuels to alternative fuels, both of which will involve technological advancement in low carbon vehicles. However, to bring such technology to the market will require

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consumers to make a behavioural change by purchasing low emission vehicles, and this will require Government support so that consumers are guided towards making such low carbon choices.

This paper argues that the existing car fringe benefits concession is an effective measure to encourage a behavioural change to low-emission vehicles, particularly as over half of all new vehicles acquired each year are fleet vehicles under the FBT regime. This would also significantly build up the country's fleet of low-emission vehicles, as vehicles under the FBT regime are sold onto the second hand market every two to three years.

Given this, the paper considers what reform is necessary to the car FBT regime to encourage a behavioural change that would build up Australia's fleet of low emission vehicles and support the environmental policy objective of significantly reducing road transport emissions.

### 1 Introduction

In Australia's quest to successfully reduce greenhouse gas emissions, the transport sector presents the greatest challenge. According to the Stern Review, the carbon emissions from the transport sector are growing faster than in any other sector,1 and this sector will be one of the last to reduce emissions below current levels.<sup>2</sup> Additionally, it is considered to be one of the more expensive sectors in which to cut emissions, because low carbon technologies tend to be high-priced, while the welfare costs of reducing demand for travel are high.<sup>3</sup>

Road emissions from passenger vehicles is the largest contributor to transport sector emissions and, according to the Organisation for Economic Cooperation and Development (OECD), "poor environment performance per vehicle combined with the huge number of passenger vehicles worldwide, means that the largest portion of GHG emissions and air pollution problems caused by the transportation sector are attributable to personal vehicles."4

Department of Climate Change, "Transport Sector Greenhouse gas emissions Projections" 2007 http://www.greenhouse.gov.au/projections/pubs/transport2007.pdf at 2. The sectors that contribute to greenhouse gas emissions include: stationary energy, transport, industrial processes, agriculture, land use and waste.

Dept of Energy and Climate Change, "2007 Energy White Paper: meeting the energy challenge" 2 para 7.8 sighted at http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/energy/ whitepaper/page39534.html accessed on 13 March 2011.

<sup>3</sup> ibid.

OECD, Environment Directorate, Environment Policy Committee, "Environmentally Harmful Subsidies in Transport Sector" 2008, para 228.

Nevertheless, the vast majority of transport emissions can be reduced through technological advances to produce low emitting vehicles.<sup>5</sup> Commissioned by the UK Government, The King Review (2008) explains that considerable CO2 emission savings can be achieved through enhancing conventional vehicle systems and by using technology such as hybrid and battery that is "close to the market".<sup>6</sup> In the short term (five to ten years), a 30 per cent saving in fuel consumption could be achieved for the average new light passenger vehicle.<sup>7</sup> However, this would require an increase in demand for low emitting vehicles, because "technology achieves nothing if it is not adopted".<sup>8</sup>

In 2008, the Garnaut Climate Change Review stated that the car benefit tax concession under the *Fringe Benefits Tax Assessment Act 1986 (Cth)* was a measure in conflict with environmental instruments such as the Carbon Pollution Reduction Scheme, and would need to be reformed.<sup>9</sup> That is, the car FBT system is not aligned with environmental policy objectives of reducing greenhouse gas emissions. Essentially, the car FBT system distorts employees' and employers' choice of vehicle by subsidising vehicle costs. This has the effect of lowering the cost of larger vehicles as well as failing to encourage the acquisition of low emission vehicles.

Most recommendations to reform the FBT system have focused on reducing emissions by discouraging unnecessary travel. In the May 2011 Budget, the Australian Government adopted the 2010 Henry Report's recommendation for car fringe benefits under the current statutory formula method to be valued at a single statutory rate of 20

- R. Garnaut. "The Garnaut Climate Change Review, Final Report", October 2008 Consultation Paper (Garnaut, R Chairman). The Garnaut Climate Change Review was initiated in April 2007 by the then leader of the Opposition, Kevin Rudd. The terms of reference of the review were to report to the Australian Government on the policies that mitigate climate change and reduce the costs of adjustment to climate change and reduce the effects of climate change, sighted on http://www.garnautreview.org.au/index.htm The Australian Governments White Paper released on 15 December 2008 acknowledges and accepts the findings of the Garnaut Climate Change Report, para 21.3.5.
- J. King "The King Review of low-carbon cars Part II: recommendations for action" March 2008 at 6 sighted at http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/bud08\_king\_1080.pdf accessed on 13 March 2011. 'The UK Chancellor commissioned Professor Julia King, Vice-Chancellor of Aston University and former Director of Advanced Engineering at Rolls-Royce plc, working with Lord Nicholas Stern, to undertake an independent review to examine the vehicle and fuel technologies which over the next 25 years could help to decarbonise road transport, particularly cars. The Review drew on expertise from across both industry in the UK and internationally, and Government.' Part I of the Review was published on 9th October 2007 which discussed the potential for reducing CO2 emissions from road transport. Part II of the report was published on 12th March 2008, which discussed the challenges, making recommendations to the government, industry, the research community and consumers on the potential for reducing CO2 emissions.
- 7 ibid.
- 8 J. King, above n 6, at para 4.6.
- 9 Garnaut Review, above n 5, Chapter 19 "Complementary Measures" para 19-1.

per cent, regardless of kilometres travelled.  $^{10}$  The tax applies to new contracts entered into on 10 May 2011 after 7.30pm (AEST), and will be phased in over four years. 11 This amendment to the Fringe Benefits Tax Assessment Act 1986 was introduced into the Commonwealth Parliament on 2 June 2011 in the Tax Laws Amendment (2011 Measures No 5) Bill 2011. 12

However, the reform fails to identify other behavioural effects that are harmful to the environment. In these terms, a 2009 study by Copenhagen Economics carried out for the European Commission (EU Study) on the "harmful environmental effect of company car subsidies" in the EU, member states found an increase in the total number of cars, and that most cars under the subsidies were bigger, higher-emitting vehicles.13

The tax-transfer system is not limited just to revenue raising; rather, it is internationally recognised as an effective instrument that can influence the demand for low emission vehicles, deliver better fuel efficiency, and lower greenhouse gas emissions. On this premise, the paper argues that the reform of the FBT system fails to encourage a behavioural change to low emission vehicles and increase Australia's fleet of such vehicles, particularly when more than half of all new vehicles sold each year are acquired under the FBT system.14

This paper discusses the importance of the FBT system as an effective instrument in reducing road transport emissions. An analysis of the current FBT system, the call for reform made by various Committees, and the Henry Report which has since been adopted by the Government, will demonstrate that all proposals for reform have failed to encourage a behavioural shift to low emissions vehicles. This paper argues that such a shift is essential if emissions are to be significantly reduced; indeed, according to the OECD, deep cuts to GHG in the transport sector require a reduction in the carbon intensity of travel, not just a reduction in kilometres travelled. 15

- Australian Treasury, Henry Final Report, "Australia's future tax system" (2010) Treasury at 372 sighted at www.treasury.gov.au.
- W.Swan MP, Treasurer 'Reforms to Car Fringe Benefit Rules' sighted at http://www.treasurer.gov. au/DisplayDocs.aspx?doc=pressreleases/2011/050.htm&pageID=003&min=wms&Year=&Doc Type=0 accessed on 21 May 2011. The reform will only apply to new vehicle contracts entered into after 7.30pm (AEST) on 10 May 2011 and will be phased in over four years.
- Schedule 5 Car fringe benefits to the Tax Laws Amendment (2011 Measures No.5) Bill 2011 replaces the current statutory rates with a single statutory rate of 20 per cent.
- European Commission, "EU study on company car taxation" (2009) by Copenhagen Economics sighted on http://ec.europa.eu/taxation\_customs/resources/documents/taxation/gen\_info/ economic\_analysis/tax\_papers/taxation\_paper\_22\_en.pdf accessed on 21 March 2011.
- ANZ Economics and Market Research, "Motor Vehicle Outlook 2009: a hard road ahead for vehicle sales" issued 27 February 2009, at 3, sighted on www.anz.com.
- K Van Dender & P. Crist, OECD ITF "Policy instruments to limit negative environmental 15 impacts from increased international transport" (2008) para 20 at 9, sighted at www.oecd.org/ dataoecd/12/53/41612575.pdf accessed on 31 May 2010.

The final section of the paper proposes that the reform of the FBT system should have adopted a 'polluter pay' system. To exemplify this, the paper applies the UK model of Company Car Taxation to the Australian car FBT system, by linking the statutory fraction to the vehicles' carbon emissions. Under this reformed system, polluters would not be subsidised for the vehicle costs of their high emitting vehicle, while the car tax concession would encourage the uptake of low emission vehicles.

The paper acknowledges that the Australian motor vehicle industry would strongly oppose any reform likely to affect the domestic fleet sales of their large passenger vehicles. However, failure by the Government to reform the FBT system based on a vehicle's emission performance has allowed the industry to continue to manufacture mostly high polluting vehicles.

### 2 Significant reduction of road transport emissions from vehicle technology

To reduce greenhouse gas (GHG) emissions, the EU Study (2009) points out that road transport needs to use less petroleum-based fuels as there is a direct link between improved fuel efficiency and lower CO2 emissions. 16 The transport sector, however, is dominated by such fuels, which contribute more than 97 per cent of primary energy consumed.<sup>17</sup> Less dependency on petroleum-based fuels, then, will require a shift of Australia's passenger fleet to low emitting vehicles and future technological advancement that is focussed on decarbonisation of road transport.

Significant reductions in CO2 emissions could be achieved through use of technologies that are currently available, and through individuals making smart choices about what to drive. 18 According to the 2008 UK King Review on the potential for reduction in carbon emissions, changes in choices by consumers to low emission vehicles would bring a projected 10-15 per cent reduction in GHG emissions from road emissions, much of which could occur over the next few years without compromising comfort or convenience.<sup>19</sup> The Review also claims that an almost complete decarbonisation of road transport by 2050 was a "realistic ambition", 20 one that could be achieved by "bringing existing technologies from the shelf to the showroom as quickly as possible."21 Again, this would be dependent on a behavioural change by consumers toward low-emission vehicles, as technology "achieves nothing if it is not adopted."<sup>22</sup>

<sup>16</sup> European Commissions above n 13, at 9.

<sup>17</sup> Garnaut, above n 5, at para 7.1.3.

King Review, above n 6, para 8, Executive summary.

King Review, above n 6, at 7. 'The King Review of low-carbon cars' Part II: recommendations

<sup>20</sup> King Review, above n 6, at 4. 'The King Review of low-carbon cars' Part II: recommendations for action'.

<sup>2.1</sup> King Review, above n 6, at 5.

King Review, above n 6, at 7.

In 2009, the Australian Government proposed influencing consumers' decisions in acquiring low emission vehicles by introducing a 'cap and trade' emission trading mechanism known as the Carbon Pollution Reduction Scheme (CPRS) to limit greenhouse gas emissions.<sup>23</sup> The CPRS increases fuel prices by the cost of emitting carbon; thus it provides the necessary price signal to influence consumers toward purchasing more fuel-efficient vehicles. <sup>24</sup> This will increase demand for more efficient vehicles and contribute to the development of new vehicles and fuel technologies.<sup>25</sup> However the CPRS was rejected in Parliament twice, and on 27 April 2010 the Australian Government announced the scheme would be deferred. Further discussion of the CPRS is outside the scope of this paper.

Even with a CPRS, the Garnaut Review points to the need for additional measures to support the uptake of low-emissions technologies.<sup>26</sup> The UK King Review explains that complementary policy measures would be required because an emission-trading scheme was not the total solution to reducing transport car emissions given that consumers are 'loss averse' and discount heavily the future cost savings from fuel efficiency.27

Behavioural change to low emission vehicles is difficult when people's concern for the environment is not reflected in their choice of vehicle.<sup>28</sup> Indeed, environmental factors such as fuel efficiency are among the least important considerations for new car buyers.<sup>29</sup> Consumers are unwilling to pay a higher purchase price by choosing a more fuel efficient-vehicle, even though they will realise future savings in the

- Australian Government, Department of Climate Change White Paper "Carbon Pollution Reduction Scheme: Australia's Low Pollution Future" released paper on 15/12/2008, Chapter 6 Coverage at 6-9, http://www.climatechange.gov.au/publications/cprs/white-paper/cprswhitepaper.aspx The White paper follows on from the 'Green Paper' released in July 2008 and takes into account many submissions from business and the report from Professor Garnaut Climate Change Review, para 5-7.
- 24 White paper, above n 23, at para 6-10.
- White Paper, above n 23, at para 6-5. Modelling by the Australian Government Treasury indicates that a carbon price has the 'potential to induce significant reductions in transport emissions' by reducing total road consumption by around 20 per cent by 2050 and
  - reduce fuel intensity and lower demand for transport fuels; and
  - reduce the use of traditional petrol; and
  - increase the uptake of electric and hybrid electric vehicles projected to make up 10 per cent of the transport sector by 2050.
- 26 Garnaut Review, above n 5, para 17-1-2.
- 27 King Review, above n 6, para 3.34.
- King Review, above n 6, at 28. There is a "gap between people's attitudes towards the environment and their actions through their choice of vehicle and the way they drive."
- B Land & S Potter, "The adoption of cleaner vehicles in the UK: exploring the consumer attitude 29 - action gap" Journal of Cleaner Production Vol 15, 2007, p1085 - 1092, para 4.2. This is also supported in the 2008 UK King Review.

reduced spending on fuel.<sup>30</sup> Non-environmental factors (costs, performance, styling, and image) may well be deemed more important by consumers when deciding on a vehicle.<sup>31</sup> However, business, government and rental fleet buyers are influenced by other factors when choosing their fleet vehicles, such as 'buy Australian'32, purchase price, the vehicle's reliability, maintenance, and resale value. 33 Moreover, influencing fleet managers' purchase decisions is important, when their choice of vehicle determines the amount of carbon emitted over the rest of the life of the vehicles.<sup>34</sup> Given that fleet managers are sensitive to the high price of low carbon vehicles,<sup>35</sup> it is argued that the car FBT system would be an effective measure in subsidising the high vehicle cost and encouraging a behavioural change to such vehicles.

### 3 Car benefits provided under the Fringe Benefits Tax Assessment Act

Employers commonly offer employees a company car as part of their salary package, a non-cash benefit that is available for their private use. Prior to the introduction of the Fringe Benefits Tax Assessment Act (FBTAA) in 1986, employees would either fail to disclose or undervalue the non-cash benefit in their tax return, resulting in little or no tax being paid and subsequent revenue leakage to the Government.

Consequently, the Australian Government introduced the Fringe Benefits Tax Assessment Act in 1986, which placed the responsibility for disclosure and taxation of fringe benefits on the employer. The fringe benefits tax rate of 46.5 per cent equals the top personal income marginal rate, currently at 45 per cent, plus the Medicare Levy of 1.5 per cent, which is applied to the grossed-up taxable value of the fringe benefit.

The employer has the choice of adopting either of the following methods in calculating the taxable value of the car benefit: the statutory formula method<sup>36</sup> known as the default method, or the operating cost method.<sup>37</sup>. Both methods provide a subsidy,

- 30 King Review, above n 6, at 7 The King Review findings show that 'on average, consumers apply a very high discount rate (60 per cent), which implies that they are looking to an 18 month payback period for fuel costs' at 60.
- B Land & S Potter, above n 29, at para 4.2. See also King Review, above n 6, at 60. The King Review findings indicated, "people tend to purchase cars on the basis of up-front price, reliability, comfort and safety. Environmental concerns do not figure highly. Traditional preferences such as appearance, power, image and brand still feature much more strongly in people's decisionmaking than the environment and emissions."
- D. Borthwick, National Transport Commission, "Vehicle fuel efficiency consultation" 14 November 2008 sighted.
- 33 D. Borthwick, National Transport Commission, above n 32.
- D. Borthwick, National Transport Commission, above n 32.
- 35 B Land & S Potter, above n 29, para 4.2.
- 36 Fringe Benefits Tax Assessment Act 1986 (Cth) (FBTAA) S 9.
- FBTA A S10. 37

namely, a tax concession that reduces the "overall cost of car ownership" <sup>38</sup> regardless of the vehicle's environmental performance.

The statutory formula method may be preferred by employers because it is the simplest to administer, thus saving them compliance costs. That is, the taxable value of the car benefit is determined by applying a statutory fraction to the 'base value'<sup>39</sup> of the car. The statutory fraction to be applied will depend on when the new vehicle contract was entered into. The Australian Government announced changes to the statutory fraction that will apply only to new vehicle contracts entered into after 7.30pm (AEST) on 10 May 2011, by replacing the four-tiered statutory fractions shown in Table 1 with a single flat rate of 20 per cent, discussed in paragraph 4.0.

### 3.1 Statutory formula method prior to 11 May 2011

For new vehicle contracts entered into before 7.30pm (AEST) on 10 May 2011, the four-tiered statutory fractions 40 shown in Table 1 will continue to apply. The applicable statutory fraction will depend on the total kilometres travelled by the vehicle each tax year. Table 1 indicates that the more kilometres travelled each year, the lower the statutory fraction and tax liability.

| Table 1: Calculation of the car benefit 'taxable value of car benefit' using the FBT |
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| statutory percentage on a motor vehicle with a base value of \$50,000                |

| Kilometres<br>travelled | Statutory<br>fraction | Taxable<br>value | Gross up<br>2.0647 | Tax<br>payable<br>46.5% | Tax<br>Savings<br>(from first<br>band)<br>\$ | Tax<br>Savings<br>(from first<br>band)<br>% |
|-------------------------|-----------------------|------------------|--------------------|-------------------------|--|---|
| More than<br>40,000     | 0.07                  | 3,500            | 7,226              | 3,360                   | 9,121  | 73  |
| 25,000 –<br>39,999      | 0.11                  | 5,500            | 11,356             | 5,280                   | 7,201  | 57  |
| 15,000 –<br>24,999      | 0.20                  | 10,000           | 20,647             | 9,600                   | 2,881  | 23  |
| Less than<br>15,000     | 0.26                  | 13,000           | 26,841             | 12,481                  |  |   |

Tax savings more than double when the car is driven 25,000 kilometres, which is why employers remind staff with company cars to go on travelling expeditions known as the 'March rally' in order to increase kilometres travelled and thus attract a lower

Dr K Henry 'Australia's Future Tax System' Consultation Paper (2008) at 261, sighted at http:// taxreview.treasury.gov.au/content/ConsultationPaper.aspx?doc=html/publications/Papers/ Consultation\_Paper/foreword.htm accessed on 10 March 2011.

FBTAA S 136, 'base value' of the car is the cost price of the car or the leased value S9(2).

<sup>40</sup> FBTAA S 9(2)(c).

statutory fraction and reduce the FBT liability.<sup>41</sup> Whether the employee needs to go on a March rally and make up the extra kilometres will depend on the structure of the employee's remuneration package. That is, the cost incurred by the employer in providing the car benefit, including the employer's FBT liability, will be charged against the salary package. So an estimate of the kilometres likely to be travelled needs to be made upfront in order to calculate this FBT liability, which the employer pays by instalments throughout the year. If in March the vehicle has not travelled enough kilometres as required under the salary package to reach the above pre-determined statutory threshold, the employee is then faced with either driving the additional kilometres to reach this threshold or having to make up the extra FBT liability through adjustment to the employee's cash salary. However, the above tax savings in Table 1 make it worthwhile for the employee to drive the extra kilometres, regardless of the increase in fuel costs, and car wear and tear.

This was evident in the 2008 survey undertaken by the fleet management company, SG Fleet, which shows that of its 15,496 novated leases in the FBT year ended 30 March 2008, a disproportionate number of drivers travelled between 15,000 and 16,000 kilometres where the statutory rate is 20 per cent, and between 25,000 and 26,000 kilometres where the statutory rate is 11 per cent.<sup>42</sup> The data indicates that drivers aim for particular kilometre bands in order to reduce their FBT liability. That is, the cost of driving an extra 2,000 to 3,000 kilometres in order to fall within a lower FBT bracket means moving from the statutory fraction bracket of 20 per cent to 11 per cent, as shown in Figure 1.

Interestingly, the Australian Government acknowledges in its annual Tax Expenditure Statement (TES) that this approach "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 employees out of after tax cash remuneration." The Australian Government estimates in its annual TES that the tax expenditure associated with the cost of providing the vehicle plus the associated running cost under the statutory formula method was \$1.140 million for 2010, and that it is projected to rise in the future. His tax expenditure is described as

<sup>41</sup> Parliament of Australia, Senate Committee for Rural and Regional Affairs and Transport "Investment of Commonwealth and State funds in public passenger transport infrastructure and services" (2009) para 5.57 sighted at http://www.aph.gov.au/senate/committee/rrat\_ctte/ completed inquiries/index.htm accessed on 13 March 2011.

<sup>42</sup> Bracks Review, was named after its chairman Hon Steve Bracks, Leader of the 2008 Review of Australia's Automotive Industry at 69 "SG Fleet, Submission to the 2008 Automotive Review", sighted at www.innovation.gov.au/automotivereview.

<sup>43</sup> Australian Government Treasury, "Tax Expenditures Statement" (2010) D18, sighted at http://www.treasury.gov.au/documents/1950/PDF/2010\_TES\_consolidated.pdf accessed on 22 June 2011.

<sup>44</sup> Australian Government Treasury, above n 43 at D18 2010-11 \$1.110m; 2011-12 \$1.220; 2012-13 \$1,290; 2013-14 \$1,340.

a "revenue forgone estimate" that identifies the financial benefit of the tax concession to taxpayers receiving those concessions relative to taxpayers that do not. 45

Nevertheless, the introduction of the statutory formula method has been justified for two reasons. Firstly, its simplicity in application may be preferred by some employers in terms of reduced compliance costs<sup>46</sup> and, secondly, because of the concessions support for the Australian car industry discussed further in paragraph 6.0.

### 3.2 FBT car concession is a "perverse subsidy"

The existing graduated statutory rates and the reformed singe statutory flat rate of 20 per are both "perverse subsidies" 47 that encourage harmful environmental behaviour and negate or limit the effectiveness of environmental policy objectives of reducing greenhouse emissions. The graduated statutory rates may provide an incentive for unnecessary travel, but the 2009 EU Study reveals additional behavioural effects can apply to both subsidies. That is, subsidising vehicle costs encourages 'over purchasing' of cars, leads to more fuel consumed, more congestion and more emissions, as well as distorts employees and employers toward choosing larger, higher emitting vehicles than would have been acquired privately. <sup>48</sup> The 2009 EU study explains that the dominance of larger company cars is arguably linked to such cars being offered to persons with above average salaries who would demand larger models.<sup>49</sup>

In Australia, this is evidenced by the National Transport Commission's (NTC) 2009 findings that private buyers had the lowest average emissions (210 grams of CO2/km), followed by business buyers (233 g/km) and government buyers (238 g/km)<sup>50</sup>.

The findings from the 2009 EU Study indicate that the subsidy has substantially increased the EU's total stock of cars because the subsidy has made it attractive for employees to take their remuneration in the form of cars. The 2009 EU Study extrapolated the results of two Dutch studies scaled up to the EU level, estimating that the increase in vehicle stock for the EU could be between 8 to 21 million.<sup>51</sup> The EU study states that "the results should be interpreted as possible orders of magnitude rather than precise estimates of effects."52

- 45 Australian Government Treasury, above n 43 at D18.
- 46 C.Black 'Fringe benefits tax and the company car: Aligning the tax with environmental policy' (2008) at 186, 25 EPLJ 182.
- Myers N & Kent J, "Perverse Subsidies: Tax \$s Undercutting Our Economies and Environments Alike". The International Institute for Sustainable Development, Winnipeg, Manitoba. Myers and Kent defined 'perverse subsidies' as those that are detrimental to both the environment and the economy in the long run.
- European Commission, "EU study on company car taxation" (2009) above n 13, para 3.4. 48
- European Commission, "EU study on company car taxation" (2009) above n 13, para 1.2. 49
- National Transport Commission, (NTC) "Carbon Emissions from New Australian Vehicles" (2009) para 5.63 sighted at http://www.ntc.gov.au/filemedia/general/carbonemissionsfromnew ausvehicle.pdf accessed on 13 March 2011.
- 51 European Commission, "EU study on company car taxation" (2009) above n 13 para 1.2.
- European Commission, "EU study on company car taxation" (2009) above n 13 para 1.2.

Even though the magnitude of the increase in the total number of cars in Australia resulting from the introduction of the car FBT subsidy on Australia's motor vehicle fleet is unknown, the EU Study does indicate that an increase in Australia's fleet would have occurred.

# 3.3 Impact of the FBT scheme on Australia's motor vehicle fleet

The official VFACTS data released by the Federal Chamber of Automotive Industries (FCAI) shows that more between 700,000<sup>53</sup> and 800,000<sup>54</sup> new passenger and sports utility vehicles (SUV) are sold each year. Indeed, business, government and rental fleet buyers acquire over half of all new vehicles sold annually,<sup>55</sup> which are most likely to be vehicles under the FBT system.<sup>56</sup>

In 1999, the Review of Business Taxation by the Ralph Committee in its final report, *A Tax System Redesign (Review of Business Taxation 1999)*, acknowledged that the concessional tax treatment of car fringe benefits provides a strong incentive for some employees to take a car as part of their remuneration package.<sup>57</sup> Again, in 2008, the Henry Review<sup>58</sup> states that the subsidy encourages employees to "skew their consumption towards motor vehicle services."<sup>59</sup> For example, the number of statutory car benefits increased by 12.7 per cent in the 1996-1997 income year when the number of statutory car benefits was 481,543,<sup>60</sup> compared to 542,891 vehicles in

- 53 FCAI 'New Vehicle Market' 2009. Total passenger motor vehicle sales were 540,562 passenger vehicles and 188,153 SUV's, total of 728,715, sighted at http://www.fcai.com.au/sales/new-vehicle-market accessed on 28 May 2011.
- 54 T.Thoresen, "Australia's new car fleet: fuel consumption trade-offs 1985-2005" at 14 New passenger vehicle sales for 2007 was 637,019 and SUV's were 198,176, total of 835,195.
- 55 ANZ Economics and Market Research, "Motor Vehicle Outlook 2009: a hard road ahead for vehicle sales issued 27 February 2009, at 3, sighted on www.anz.com.
- 56 Parliament of Australia, Senate Committee for Rural and Regional Affairs and Transport "Investment of Commonwealth and State funds in public passenger transport infrastructure and services" (2009) above n 41 para 5.63.
- 57 Review of Business Taxation (RBT) chaired by Mr John Ralph, was known as the Ralph Committee. The discussion paper was entitled: "A Platform for consultation" and the final report was entitled "A Tax System Redesigned." The discussion paper referred to the distortionary effect of the statutory formula. at 774.
- 58 Henry Review, named after Dr Ken Henry, Secretary to the Treasury, who chaired the 2008 Review Panel of Australia's Future Tax system. The Review Panel comprised of Mr Greg Smith (Australian Catholic University); Dr Jeff Harmer (Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs), Heather Ridout (Australian Industry Group), and Professor John Piggott (University of New South Wales).
- 59 Henry Review, above n 38, at 90.
- 60 Warren.N., "Fringe Benefit Tax Design: Decision Time" Institute of Chartered Accountants in Australia, (2006), refers to ATO statistics for 1996-1997, sighted at www.charterteredaccountants. com.au/files/documents/Institute\_FBT\_report(150306).pdf.

2007-08,<sup>61</sup> with 1,156,179<sup>62</sup> vehicles in 2007-08 using the FBT operating cost method. Therefore, in 2008, there were an estimated 1,699,070 vehicles provided by way of fringe benefits, representing 14.4 per cent of Australia's registered passenger fleet.<sup>63</sup> This percentage would be higher if all vehicles acquired under the FBT system that were sold into the second hand market every two to three years were included in the above figure. In effect, the fleet-purchasing decision made by the fleet manager is important, as it contributes to road transport emissions for the life of the vehicle - an average of 10 years.64

However, fleet managers are sensitive to the high purchase price of low carbon vehicles or low emitting vehicles, 65 and claim that the current FBT system "actively provides financial disincentives" because of the additional costs incurred in purchasing vehicles with environmental features such as LPG or a diesel engine.<sup>66</sup>

On the basis of this, the Australian Fleet Managers Association Inc (AfMA)<sup>67</sup> criticised the FBT system for becoming 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."68 Given that the additional cost of acquiring low emission vehicles made such vehicles less financially attractive to Fleets, the AfMA recommended that:

"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."69

Given the importance of this taxation measure, the paper examines the impact of the reform of the FBT system announced on 10 May 2011, and considers what reform is necessary to align the taxation measure with environmental policy objectives of delivering the favourable environmental effect of reducing road transport emissions.

- ATO Statistics, Table 7B of the 2007-2008 Table 8.8, number of vehicles using the statutory formula method who have completed a FBT return.
- Senate Committee on Rural and Regional Affairs and Transport "Inquiry into the investment of Commonwealth and State funds in pubic transport infrastructure and services' Appendix 4 at 111.
- Australian Bureau of Statistics, "9309.0 Motor Vehicle Census, Australia' 31 Mar 2008" at 3. There were 11,803,536 million registered passenger vehicles at 31 March 2008, sighted at http://www. abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/9309.031%20Mar%202008?OpenDocument.
- ABS, "9309.0 Motor Vehicle Census, Australia, 31 Mar 2009" sighted at http://www.abs.gov.au/ ausstats/abs@.nsf/mf/9309.0/ The average age for vehicles is 10.0 years for vehicles registered in 2010. This is older than the 9.9 years recorded in 2009, with 20 per cent of these vehicles being manufactured before 1992. http://www.ntc.gov.au/filemedia/News/SubmissionVehiclFuelEfficD PNov08.pdf accessed on 10 March 10, 2011.
- 65 B. Lane and S. Potter above n 29, at para 4.2.
- Australasian Fleet Managers Association, 'The Australasian Fleet Managers Association (AfMA) Submission regarding Fringe Benefit Tax (FBT)' 18 December 2008, at 4.
- Australasian fleet Managers Association is a not for profit organisation responsible for the 67 management of approximately 800,000 vehicles.
- 68 Australasian fleet Managers Association, above n 66.
- 69 Australasian fleet Managers Association, above n 66.

# 3.4 Removal of the car fringe benefits tax concession?

Many submissions have recommended the removal of the FBT concessions for company cars. In 2000, the Australian Parliament report, *The Heat is On: Australia's Greenhouse Future*, recommended that the FBT incentive for company cars be removed and incentives that encourage public transport and cycling be introduced.<sup>70</sup> In 2002, the Australia Institute recommended the removal of the concessionary tax treatment of company cars.<sup>71</sup>

The House Standing Committee on Environment and Heritage report on *Sustainable Cities* (2005) also recommended the removal of incentives for greater car use, but proposed that the incentive should be extended to other modes of transport.<sup>72</sup>

The OECD recommended that policy makers should attempt to understand the environmental effects of removing a subsidy, and how consumers and producers are likely to react to the removal of that subsidy.<sup>73</sup> Thus, to remove the FBT subsidy with the goal of reducing environmental pressures, the OECD advises that "it is essential to consider the broader sectoral and macroeconomic context of a particular subsidy"<sup>74</sup> such as its impact on the local car industry (discussed in paragraph 6.0). Removal of a subsidy without considering its context could have the opposite effect to that which was intended.<sup>75</sup> Therefore, if removing the FBT tax concessions results in employers' offering cash allowances in place of a company car, which is then used to acquire a car privately that is fuel inefficient, then the removal of the FBT subsidy will have minimal benefit to the environment. Alternatively, if reforming the FBT subsidy reduces the cost of vehicle use for low emission vehicles and results in an increase in Australia's fleet of fuel-efficient low emission vehicles, then the environmental impact of reforming the FBT subsidy is positive.

<sup>70</sup> Australian Parliament, Senate Environment, Communications, Information Technology and the Arts References Committee, "The Heat is On: Australia's Greenhouse Future (2000)" Recommendation 48, at 230.

<sup>71</sup> C. Hamilton, R. Dennis, H. Turton, "Taxes and Charges for Environmental Protection" *The Australian Institute*, (2002) at viii, Discussion Paper No 46 https://www.tai.org.au/documents/downloads/DP46.pdf.

<sup>72</sup> House Standing Committee on Environment and Heritage, Sustainable Cities (2005), http://aph.gov.au/house/committee/environ/citieis.htm Recommendation 8, p77 Chapter 5 of the Report considered transport sustainability and identified environmental, economic and social costs linked to heavy reliance on the private car (p59), and the impediments to reducing this dependency was the concessions available to private vehicles under the FBT. (p45).

<sup>73</sup> OECD, above n 4, at para 2.1.

<sup>74</sup> OECD, above n 4, at para 279.

<sup>75</sup> OECD, above n 4, at para 279.

### 3.5 Proposals for reforming the car fringe benefits tax system

All proposals for reforming the FBT system were more concerned with removing the incentive for unnecessary travel. None of the proposals considered the possibility that the tax concession could have other harmful environmental effects identified in the 2009 EU study on company car taxation, such as the subsidy distorting an employee's decision toward choosing a larger vehicle than required and increasing the total number of vehicles on road, as discussed earlier in paragraph 3.2.76

For instance, the final report of the 1999 Ralph Committee Review of Business Taxation recommended a revenue neutral approach for the FBT system by replacing the current statutory formula with a schedule of operating costs of the vehicle under which 45 per cent (business-use percentage) is deducted to determine the taxable value of the employee's car benefit.<sup>77</sup> The business-use percentage could exceed the prescribed percentage providing the claim could be substantiated.<sup>78</sup> Administratively, there were compliance cost advantages as the method was simple in that the vehicles' running costs would be determined from a schedule, which eliminated the need for record keeping. Furthermore, the link to unnecessary kilometres travelled was removed.

In 2007, the Senate Standing Committee on Rural and Regional Affairs and Transport in its report Australia's Future Oil Supply and Alternative Transport Fuels, recommended that the government review the statutory formula method of valuing car fringe benefits to address the perverse incentives it creates for more car use.<sup>79</sup>

In August 2007, the Australian Government appointed the then Secretary to the Treasury, Dr Ken Henry, to chair a Review Panel (Henry Review) into Australia's future tax system for the next 10 to 20 years, and make recommendations for the design of the country's future tax-transfer system.80

According to the terms of reference, the objective of the review was to create a tax transfer system that would position Australia to meet demographic, social, economic and environmental challenges.<sup>81</sup> In terms of the environment, consultation questions were asked of business and the broader community on how to reform policies that have the potential to improve both the structure of the tax transfer system and the

European Commission, "EU Study on company car taxation", above n 13.

Ralph Committee,(1999) "RBT, A Tax System Redesigned' Discussion paper: A Platform for Consultation" (1999) at 223 para 5.4(a) The schedule of operating costs was based on the published surveys conducted by motoring organisations of aggregate running costs (both fixed and variable) of vehicles.

Ralph Committee (1999) above n 77, at 223, para 5.4(a).

Senate Standing Committee on Rural and Regional Affairs and Transport, "Australia's Future Oil Supply and Alternative Transport Fuels, Final Report" (2007) http://www.aph.gov.au/senate/ committee/rrat\_ctte/oil\_supply/index.htm p163 Recommendation 10.

Henry Review above n 38, 'Overview' at Section 13. 80

Henry Review, above n 38 'Executive Summary'. 81

environmental outcome by changing the incentives faced by individuals and firms.<sup>82</sup> The Henry Review raised the consultation question of the FBT treatment of car benefits that impact on the everyday decisions of individuals and businesses and may create incentives that impact adversely on environmental outcomes.<sup>83</sup> Submissions were invited from individuals, academics, business and the broader community to provide feedback to these consultation questions. The Review Panel provided the final report to the Treasurer by the end of 2009, which was released to the public in May 2010. The recommendations from this review are discussed in paragraph 3.6.

The 2008 Garnaut Review recommended to the Review Panel that the FBT statutory fraction method be amended to ensure it was distance neutral.<sup>84</sup>

The 2008 Review of Australia's Automotive Industry, *A New Car Plan for a Greener Future* (commonly known as the Bracks Review), recommended to the Henry Review the "adoption of a new fringe benefits tax statutory rate table that is more evenly spread across the range of kilometres travelled." The rate table commences from the same statutory fraction of 26 per cent for kilometres travelled per FBT year of 0 to 14,000, increasing in increments of 2,000 kilometres, with the highest band remaining the same as the existing statutory fraction of 7 per cent for kilometres travelled at 40,000 per FBT year, as shown in Table 1. The Bracks Review claimed that the new rate table would encourage drivers to use their vehicles only when necessary and not for the purpose of reducing FBT liability. The Review also indicated that some submissions recommended a flat structure rate; however, it rejected this proposal as a rate that is too low could reduce the cost of salary packaging vehicles and erode the effectiveness of the FBT system, while a high rate could remove the incentive for salary package vehicles altogether.

- 82 Henry Review, above n 38, at 247. The following consultation questions were presented for consideration:
  - Q13.1 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?
- 83 Henry Review, above n 38, at para 13.2 p 249.
- 84 Garnaut Review, above n 5, at 527.
- 85 Bracks Review, above 42, at 69 The new rate table proposed the following statutory fractions: 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%; 24,001-26,000:11%; 26,001-34,000:10%; 34,001-40,000:9%; 40,000:7%.
- 86 Bracks Review, above n 42, at 69.
- 87 Bracks Review, above n 42, at 69.

In August 2009, the Senate Standing Committee on 'Investment of Commonwealth and State funds in public passenger transport infrastructure and services' investigated the need for improvement in urban public transport and the fringe benefits taxation of cars. The Committee recommended an "amendment to the car FBT statutory formula to remove the incentive to drive fringe benefits cars excessively to reach the next threshold."88 The Committee also recommended that "it would be preferable to increase the number of distance bands rather than use a flat rate, since a flat rate advantages cars which are driven further, which should be seen as contrary to environmental goals to restrain car use."89

In 2007, Kraal, Yapa and Harvey conducted a survey of 1,250 cars in both metropolitan and regional areas on the FBT system, and confirmed that the FBT's statutory formula method encourages employees to "drive unnecessary mileage in salary packaged vehicles to obtain tax concessions."90 The authors recommended to the Henry Review that the FBT's statutory rates for cars be reformed by "removing the tax concession at the 15,000 kilometre band and using the statutory fraction band of 26 per cent rate, or using a single statutory rate of 20 per cent."91 The recommendation was described as an "environmentally sustainable car salary packaging." The authors' preferred solution to determine the taxable value of the car fringe benefit was the use of the Operating Cost Method. This would facilitate the "...curbing of excessive motor vehicle greenhouse emissions and foster petrol savings", because it is the most the accurate method in claiming genuine business kilometres. 93 However, business does not find this method as administratively simple as the FBT statutory formula method. Indeed, the Operating Cost Method may well remove the excess kilometres driven, but the subsidy reduces vehicle costs and fails to encourage a behavioural change to low emission vehicles.

Parliament of Australia, Senate Committee for Rural and Regional Affairs and Transport, above n 40, para 5.79 Recommendation 7.

Parliament of Australia, Senate Committee for Rural and Regional Affairs and Transport Senate Committee, above n 40, at para 5.78.

Kraal, Yapa and Harvey, "The impact of Australia's Fringe Benefits Tax for cars on petrol consumption and greenhouse emissions" (2008) Australian Tax Forum at 191.

<sup>91</sup> Kraal, Yapa and Harvey, above n 90, at 215. The survey showed that 20 per cent of car drivers travelled the necessary kilometres to reach the 15,000 km, 25,000 km and 40,000 km, and 80 per cent of employees live within 15kms of their workplace.

<sup>92</sup> Kraal, Yapa and Harvey, above n 90, at 216.

Kraal, Yapa and Harvey, 'Fringe benefit tax for cars: some further considerations for policy change and reform' (2009) Australian Tax Forum at 590 sighted on 7 March 2011.

However, the OECD stated that the largest proportion of GHG emissions in the transport sector is attributable to the environmental performance of personal vehicles, not from reducing kilometres travelled. This was supported by the King Review, which found emission reduction is unlikely to be achieved through overall reductions in distance travelled, because it was more cost effective to reduce CO2 emissions through improvements in vehicle technology.

This view is also evident in the data collated by Kraal, Yapa and Harvey (2007), which provides an example of the typical car driven and the average number of cars acquired under each of the FBT statutory bands. This data has been collated in Table 2 below, and includes the fuel efficiency of vehicles and carbon emissions collated from the Green Vehicle Guide. For example, the survey indicates that in the \$36,000 to \$37,500 price bracket a typical car might be the Ford Futura, which has a fuel economy of 13 litres/100 kms and emits 298g of CO2/km, and in the \$37,500 to \$38,000 price bracket, a typical car might be a Mitsubishi Pajero RV6 with a fuel economy of 13.5/100 km, emitting 322g of CO2/km.

<sup>94</sup> OECD, Environment Directorate, Environment Policy Committee, above n 4, at para 228.

<sup>95</sup> King Review, above n 6, at para 4.6.

<sup>96</sup> King Review, above n 6, at para 2.2.

Table 2: Average number of cars per price range and number of kilometres travelled; fuel economy and carbon emissions/km $^{97}$ 

| Price<br>range of<br>cars | Typical car               | L/100<br>Km* | CO2g/km <sup>98</sup> | No<br><15<br>kms | No<br>15-25<br>kms | No<br>25-40<br>kms | No<br>>40<br>kms | Total<br>no of<br>cars | %   |
|---------------------------|---------------------------|--------------|-----------------------|------------------|--------------------|--------------------|------------------|------------------------|-----|
| Statutory<br>Fraction     |                           |              |                       | 26%              | 20%                | 11%                | %2               |                        |     |
| Less than<br>\$29,000     | Ford Focus                | 76           | 199                   | 25               | 44                 | 38                 | 35               | 142                    | 32  |
| \$29,000 to<br>\$36,000   | Commodore                 | 12L          | 280                   | 12               | 30                 | 41                 | 24               | 107                    | 24  |
| \$36,500 to<br>\$38,500   | Mitsubishi<br>Pajero RV6  | 13.5L        | 322                   | 21               | 50                 | 78                 | 16               | 135                    | 32  |
| More than \$38,500        | Jeep<br>Cherokee<br>Sport | 11.8L        | 283                   | 4                | 18                 | 22                 | 10               | 54                     | 12  |
| Total                     |                           |              |                       | 62               | 112                | 179                | 85               | 438                    |     |
| Percentage                |                           |              |                       | 14%              | 25%                | 40%                | 20%              |                        | 100 |

<sup>\*</sup> Green Vehicle Guide

Kraal, Yapa and Harvey, above n 90, with the data extracted from data table 5: average number of cars priced < \$29,000 and '000 kilometres travelled; Data Table 6 Average number of cars priced \$26,001-\$36k and '000 kilometres travelled (p 205); Data table 7 Average number of cars priced \$36,001-\$37.5k and '000 kilometres travelled; Data Table 8 Average number of cars priced \$37.5-\$38k and '000 kilometres travelled; Data Table 9 Average number of cars priced \$38-\$38.5k and '000 kilometres travelled; Data Table 10 Average number of cars priced > \$38.5k kilometres travelled. 6

Australian Government, "Green Vehicle Guide" sighted at http://www.greenvehicleguide.gov.au/GVGPublicUI/SearchResults.aspx accessed on 16 March 2011. 86

In terms of the number of vehicles acquired under each FBT statutory band, Table 2 shows 40 per cent of the vehicles acquired were in the lower FBT Statutory Fraction band of 11 per cent, and 20 per cent were in the FBT statutory fraction band of 7 per cent. In addition, Table 2 supports the 2009 EU Study<sup>99</sup> in that not only does the FBT system encourage unnecessary kilometres, but the subsidy attracts the acquisition of more expensive, higher emitting vehicles that have higher vehicle costs because they are less fuel-efficient and require more litres of fuel for the same kilometres travelled.

In fact, the Australian vehicles chosen by the taxpayers in Table 2 have emissions that are 40 to 50 per cent higher than vehicles under international best practice. That is, after measuring the environmental performance of the cars, the National Transport Council (NTC) reported that international best practice for business and government fleets was carbon emissions of 167 g/km in 2007, compared to those vehicles in Table 2 with carbon emissions ranging from 199g/km to 322g/km. 100

For example, the Ford Focus in Table 2 requires 9 litres of fuel for each 100 kilometres travelled and emits 199g of CO2 per kilometre travelled, while the Mitsubishi Pajero requires 13.5 litres of petrol for the same kilometres travelled, and emits 322g of CO2 per kilometre. However if the Ford Focus was fuelled by diesel instead of petrol, the vehicle would require only 5.6 litres of fuel per 100 kilometres travelled instead of 9 litres and emit 146g of CO2 per kilometre, thus meeting the international best practice standard of 167g/km. A further reduction in emissions would occur if there was a behavioural change to 'green cars' such as a hybrid Prius, which would require only 3.9 litres of fuel for 100 kilometres and limit emissions to 89 grams of CO2 per kilometre<sup>101</sup>, that is, 89 per cent less than the emissions from a Mitsubishi Pajero.

Recommendations for the reform of the FBT system discussed earlier fail to recognise the significant environmental effects of car choice and the varying range of emissions within every class or type, <sup>102</sup> or alternative fuels such as diesel, biodiesel or liquefied petroleum gas (LPG). For example, the findings from the UK King Review indicate the choice between petrol and diesel has a direct effect on emissions, with diesel cars currently being around 10-20 per cent more fuel–efficient than equivalent petrol models. <sup>103</sup>

However, the transition to diesel vehicles in Australia has been slow, with diesel and petrol vehicles sales accounting for 12 and 87 per cent respectively in 2008, compared

<sup>99</sup> European Commission, "EU Study on company car taxation", above n 13.

<sup>100</sup> D. Borthwick, National Transport Commission, above n 32.

<sup>101</sup> Australian Government, "Green Vehicle Guide" sighted at http://www.greenvehicleguide.gov. au/GVGPublicUI/SearchResults.aspx accessed on 16 March 2011.

<sup>102</sup> J. King, "The King Review of low-carbon cars Part I: the potential for CO2 reductions" (2007) at 63 accessed on 10 March 11, 2011. King Review provides examples of SUV's emissions can range from 150g per kilometre to over 300g per kilometre.

<sup>103</sup> J. King, above n 102, at 64.

to 52 and 48 per cent respectively in the European Union. 104 None of the vehicles in Kraal, Yapa and Harvey's (2008) FBT survey were fuelled with diesel.

When Kraal, Yapa and Harvey were questioned by the National Tax Forum in 2009 on whether to "restructure FBT for greater concessions for high fuel efficient cars" as promoted by the Australian Conservation Foundation, the authors responded: "....this solution would seem to raise more complexities and may be inequitable as it may encourage a shift to imported vehicles." 105

But the shift to imported vehicles has already happened, and does not justify the failure to reform the FBT system on the basis of a vehicle's environmental performance. In 2006, Warren of KPMG Chartered Accountants said it was "not unreasonable to assume that over half of the intended subsidy to domestic vehicle manufacturing industry arising from the application of the FBT statutory formula is now benefiting car importers", 106 and reported that sales of Australian built motor vehicles had fallen to 29 per cent in 2004. 107 However in 2010 this had more than halved to 14 per cent. 108 The issue of 'raising more complexities' was not the case when the UK reformed the Company Car Taxation (CCT) system in 2002, linking the CCT to a vehicle's carbon dioxide emissions and achieving significant reductions in CO2 emissions from cars, as discussed in paragraph 5.0.

### 3.6 Henry Report on Australia's future tax system

The Australian Government released the Henry Report entitled Australia's Future Tax System to the public on 2 May 2010. This Report recognised that the current statutory formula was introduced for non-environmental purposes, and that it may promote behaviour with adverse environmental consequences by creating "an incentive for individuals to travel additional kilometres, adding to carbon pollution and congestion." <sup>109</sup> In response to this concern, the Henry Report recommended that the car fringe benefits "be valued at a single statutory rate of 20 per cent, and would apply regardless of kilometres travelled."110

- 104 Australian Transport Council, National Transport Commission above n 50, at 29.
- 105 Kraal, Yapa and Harvey, above n 93, at 595. Kraal, Yapa and Harvey presented the above FBT findings and recommendation to a National Tax Forum symposium in 2009 to delegates who were mainly administrators from the social services not-for-profit sector. Delegates included the Australian Council for Social Securities, the Brotherhood of St Laurence, Mission Australia, various trade unions etc.
- 106 Warren, above n 60, at 18.
- 107 Warren, above n 60, at 18.
- 108 T. Hagon, "Â place for local talent" The Age, 8 January 2011, sighted on http://theage.drive.com. au/motor-news/a-place-for-local-talent-20110107-19i3b.html.
- 109 Australian Treasury, Henry Final Report, "Australia's future tax system" (2010) Treasury at 371 sighted at www.treasury.gov.au.
- 110 Refer to Table 1, where the statutory fraction band for 20 per cent will apply in calculating the FBT liability: value of car x single statutory rate of 20 per cent x gross-up rate x days held/days in FBT year x FBT rate. For a \$50,000 worth \$50,000 held for 365 days, the calculation is: \$50,000

For example, in applying the single statutory rate of 20 per cent to the vehicle worth \$50,000 in Table 1, the tax payable will be \$9,600<sup>111</sup> regardless of the kilometres travelled. This will be discussed further in paragraph 4.0

Again, the single statutory rate may reduce 'excess kilometres travelled' between the statutory fraction bands, but fails to acknowledge emissions can vary between vehicles and within every class or type of vehicle. That is, the flat rate fails to differentiate between vehicles such as an SUV that can emit between 245 to 341 grams of CO2 per kilometre travelled, and a hybrid vehicle that emits 89 grams of CO per kilometre travelled. 112

In applying the Henry Report's recommendation of a single 20 per cent statutory rate, Table 3 shows the likely reduction in carbon dioxide emissions per tonne that would occur if there were reductions in mileage of, for instance, 5,000 kilometres per year, because a vehicle no longer needs to travel the additional kilometres per year to reach the statutory band of 20 per cent under the current FBT system. Table 3 shows the reduction in CO2 emissions for the 5,000 kilometres, which will vary depending on the fuel efficiency of the vehicle and the amount of carbon dioxide emitted per kilometre travelled.

Table 3: Reduction in emissions for fewer kilometres travelled under a 20% flat statutory rate

| Car                            | L/100<br>km | CO2g/<br>km | 25,000 km<br>Total<br>Tonnes/<br>CO2 | Reduced<br>emissions<br>for 5000 km<br>CO2/tonne | Total<br>emissions<br>20,000km<br>CO2/tonne |
|--------------------------------|-------------|-------------|--------------------------------------|--|---|
| Ford Focus                     | 9L          | 199         | 4.975                                | .845   | 3.980                                       |
| Commodore<br>(Australian made) | 12L         | 241         | 6.025                                | 1.205  | 4.820                                       |
| Ford Futura<br>Wagon           | 13L         | 298         | 7.450                                | 1.490  | 5.960                                       |
| Hybrid Prius                   | 3L          | 89          | 2.225                                | .445   | 1.780                                       |
| International best practice    | 7L          | 167         | 4.175                                | .835   | 3.340                                       |

x 20% x 2.0647 x 365/365 x 46.5% = \$9,600.

<sup>111</sup> Henry Final Report, above n 109, at 372-recommendation 9b Section A1 Personal income tax. The Australian Government has not indicated whether it will accept or reject this recommendation.

<sup>112</sup> Australian Government, "Green Vehicle Guide" Toyota Landcruiser 200, 2010 model Petrol 91RON emits 341 gCO2/km, while a Holden VE sports wagon can emit between 221 g of CO2/km to 327g of CO2/km sighted at www.greenvehicleguide.gov.au

While Table 3 shows a reduction in emissions, the total tonnage of emissions for the same kilometres travelled is higher for fuel inefficient vehicles. On its own, the Henry Report's recommendation for a single statutory rate of 20 per cent will be unlikely to encourage a behavioural change to low emission vehicles. Nor will it contribute to the joint Australian Transport Council and the Environment Protection and Heritage Council's 'Vehicle Fuel Efficiency Working Group' 113 efforts in developing vehicle fuel efficiency measures that are designed to move Australia towards 'international best practice. 114 This will require "improving the greenhouse emission performance of new vehicles"115

The 'international best practice' vehicle in Table 3 emits 3.340 tonnes of carbon dioxide for each 20,000 kilometres travelled, which is less than all other vehicles except those which are low carbon. In fact, the Toyota Prius, a low carbon vehicle, emits 4.180 fewer tonnes of emissions than the Ford Futura Wagon for the same kilometres travelled. This supports the findings of the King Review that changes in consumers' choice toward low emission vehicles can bring forward a reduction of GHG emissions from road transport. 116 Table 3 clearly highlights the consequences of ignoring the harmful environments effects of the vehicle chosen by an employee or employer.

In addition, Kraal, Yapa and Harvey argue that adopting a single statutory rate of 20 per cent will foster petrol savings by removing the incentive for unnecessary kilometres travelled. 117 For example, if mileage travelled is reduced from 25,000 kilometres to 20,000 kilometres, Table 4 shows the highest emitting vehicle appears to have the greatest petrol saving of \$910, while the lowest emitting vehicle has the least petrol saving of \$210. The greatest petrol saving, however, comes from purchasing a fuel-efficient vehicle, where for each 20,000 kilometres travelled the total cost of petrol is \$840 for the Hybrid Prius and \$1,960 for the 'International best practice vehicle, compared to \$3,360 for the high-emitting Commodore and \$3,640 for the Ford Futura Wagon.

<sup>113</sup> The Vehicle Fuel Efficiency working Group was formed at the request of the Australian Transport (ATC) and the Environment Protection Heritage Council (EPHC). The working group represented Commonwealth and State/Territory transport, environment and industry representatives. The Working Group were required to assess the effectiveness of measures in an international and local context and outline potential measures to improve vehicle fuel efficiency and reduce CO2 emissions.

<sup>114</sup> Australian Transport Council and the Environment Protection and Heritage Council Vehicle Joint "Vehicle Fuel Efficiency Working Group", Final Report March 2009, at 4, sighted at http:// www.atcouncil.gov.au/documents/files/VFE\_FinalReport09.pdf accessed on 7 March 2011.

<sup>115</sup> Australian Transport Council and the Environmental Protection and Heritage Council, "Vehicle Fuel Efficiency Working Group" above n 114, at para 3.4 sighted at http://www.atcouncil.gov.au/ documents/files/VFE\_FinalReport09.pdf.

<sup>116</sup> King Review, above n 6, at 7.

<sup>117</sup> Kraal, Yapa and Harvey, above n 90, at 192.

| Car                               | L/100<br>km | 25,000<br>km<br>Total<br>Litres<br>(petrol) | Total<br>fuel cost<br>@ \$1.40<br>per litre<br>\$ | 20,000<br>km Total<br>Litres<br>(petrol) | Total<br>fuel cost<br>@ \$1.40<br>per litre<br>\$ | Total<br>Petrol<br>Savings<br>\$ |
|-----------------------------------|-------------|---|---|--|---|----------------------------------|
| Ford Focus                        | 9L          | 2,250                                       | 3,150   | 1,800                                    | 2,520   | 630                              |
| Commodore<br>(Australian<br>made) | 12L         | 3,000                                       | 4,200   | 2,400                                    | 3,360   | 840                              |
| Ford Futura<br>Wagon              | 13L         | 3,250                                       | 4,550   | 2,600                                    | 3,640   | 910                              |
| Hybrid Prius                      | 3L          | 750   | 1,050   | 600                                      | 840   | 210                              |
| International best practice       | 7L          | 1,750                                       | 2,450   | 1,400                                    | 1,960   | 490                              |

Table 4: Petrol Savings under a 20% flat statutory rate

Table 4 illustrates projected petrol savings with reduced kilometres travelled under the reformed 20 per cent flat statutory rate, while Table 3 demonstrates the likelihood of a reduction in GHG emissions. Both scenarios support the findings in Kraal, Yapa and Harvey's 2007 survey discussed in paragraph 3.5, but it is argued that the petrol savings and the reduction in carbon emissions would have been greater had taxpayers chosen low emitting vehicles at the time of acquisition.

In terms of the tax concession claimable for the fuel consumed by the vehicles listed in Table 4 under the *Income Tax Assessment Act 1997*<sup>118</sup>, a higher tax concession of \$3,640 would be claimed for the high emitting Ford Futura Wagon, which is \$2,800 more than the tax concession that would be claimed for the lowest emitting vehicle of \$840, or \$1,680 for the international best practice vehicle. It is argued, then, that this is in conflict with environmental policy objectives and the 'polluter pays principle', given that the polluter is being subsidised for higher fuel costs and higher emissions at a cost to the community and the environment.

# 4 The Government adopts Henry Report's reform

The Australian Government proposes to implement the Henry Report's recommendation for valuing car fringe benefits with a single statutory rate of 20 per cent, regardless of the kilometres travelled, to apply to new vehicle contacts entered into after 7.30 (AEST) on 10 May 2011, and phased in over four years as shown in Table 5.

Table 5: Single flat rate of 20% phased in over four years

| Existing Co   | ontracts              | New Contracts entered into after 7.30pm (AEST on 10 May 2011 |                      |                      |                      |  |
|---|-----------------------|--|----------------------|----------------------|----------------------|--|
| Distance<br>travelled during<br>the FBT year<br>(1 April – 31<br>March) | Statutory<br>fraction | From<br>10 May<br>2011                                       | From<br>1 April 2012 | From<br>1 April 2013 | From<br>1 April 2014 |  |
| 0 – 15,000 km   | 0.26                  | 0.20   | 0.20                 | 0.20                 | 0.20                 |  |
| 15,000 –<br>25,000 km   | 0.20                  | 0.20   | 0.20                 | 0.20                 | 0.20                 |  |
| 25,000 –<br>40,000 km   | 0.11                  | 0.14   | 0.17                 | 0.20                 | 0.20                 |  |
| More than<br>40,000 km  | 0.07                  | 0.10   | 0.13                 | 0.17                 | 0.20                 |  |

The Government provides no explanation of why there needs to be a phase-in period of four years. Rather, it seems only to add a further administrative burden on employers. After this period, the use of the statutory formula method will be simpler.

The Government describes the reform as both a taxation and environmental reform, in that it will remove the "unintended incentive for people to drive their vehicle further." 119 Emissions will only be reduced for the 'excess kilometres travelled' to reach the lowest statutory fraction. However, the phasing-in period shown in Table 5 will still encourage excess kilometres for employees travelling over 25,000 kilometres for a further two years, and for a further three years for employees travelling more than 40,000 kilometres during an FBT year.

The impact on the existing statutory fractions shown in Table 1 compared to the single statutory rate of 20 per cent is shown in the following table.

Table 6: The FBT of a motor vehicle with a base value of \$50,000: when applying the FBT four tiered statutory fractions compared to the single statutory rate of 20%

| Kilometres<br>travelled | Statutory<br>fraction | Tax<br>payable<br>46.5% | Tax payable<br>Applying<br>single flat<br>rate of 20% | Tax<br>(Savings ) or<br>Additional tax |
|-------------------------|-----------------------|-------------------------|---|--|
| More than 40,000 km     | 0.07                  | 3,360                   | 9,600   | 6,240                                  |
| 25,000 – 39,999 km      | 0.11                  | 5,280                   | 9,600   | 4,320                                  |
| 15,000 – 24,999 km      | 0.20                  | 9,600                   | 9,600   | Nil                                    |
| Less than 15,000 km     | 0.26                  | 12,481                  | 9,600   | (2,881)                                |

Undoubtedly the reform will disadvantage employees who travel between 25,000 and 40,000 km, with an additional tax of \$4,320, and for those who travel over 40,000 km, an additional tax of \$6,240. Therefore the reform discourages the perverse incentive to drive excessive kilometres to reduce tax liability. However, the additional taxes may remove some of the incentive for choosing the statutory formula method, and taxpayers with high kilometres may find it more attractive to use the operating cost method.

Nonetheless there is still a tax saving to the high-income earner, who will not necessarily be discouraged to include a car as part of their salary package. In addition, the single statutory rate of 20 per cent will benefit low kilometre commuters who travel less than 15,000 kilometres. As shown in Table 1, there is a tax saving here of \$2,881. Employees who mostly travel to and from work with little additional travel may be encouraged to consider salary packaging a car. In effect, the new rate may encourage more vehicles being acquired by employees who are low kilometre users. This may very well offset any environmental gain achieved from reducing excess kilometres, and is contrary to the Treasurer's statement that this is both a taxation and environmental reform. The reform measure may in fact increase peak hour users and traffic congestion.

More importantly, both the graduated statutory rate FBT system and the new single flat rate of 20 per cent provide no incentive for taxpayers to make a behavioural change to fuel efficient, low emitting vehicles, and will not deliver significant reduction in greenhouse gas emission from road transport.

# 4.1 Cost to the community and environment

The FBT is not a major source of revenue for the Australian Government when tax revenue is offset against tax concessions. For example, in 2008-09 the estimated

tax concessions for fringe benefits were \$3.3 billion compared with FBT revenue collections of \$3.8 billion. 121

The FBT concession for the statutory formula method of \$1.7 billion in the FBT tax year 2007-08 is projected to increase to \$2 billion by 2009-10.122 This concession is considered to be one of the largest tax expenditures outside superannuation and capital gains tax. 123

With the reform of the FBT 'statutory formula' method from the four-tiered statutory percentages to a single 20 per cent flat rate, the Australian Government projects that this measure will result in a gain to revenue of \$970 million over the forward estimates, and the ongoing gain in revenue will increase GST payments to the States by \$50 million over the same period. 124 This estimate is made on the premise that this reform will remove the incentive to "drive salary-sacrificed and employer-provided vehicles to increase their concession." 125 This may be the case, but employees who travel more than 25,000 kilometres per year may shift to the operating cost method, while employees who travel less than 15,000 kilometres per year may be drawn to salary packaging. In effect, the reform may well increase the number of vehicles under the FBT system, and continue to subsidise vehicle costs without any consideration of the fuel efficiency of the vehicle chosen by the employee.

However, the tax concession represents revenue forgone each year to the Australian Government and the community had the employees' private car benefits been non concessionary. Given this concession is a cost to the community, it should then benefit the community and environment by encouraging the acquisition of low emission vehicles that will build up Australia's fleet of low emission vehicles and encourage further technological advancement in decarbonising road vehicles.

The Australian Vehicle Fuel Efficiency Working Group's Final Report in 2009 identified that taxation measures are being utilised around the world to improve vehicle fuel efficiency and reduce CO2 emissions from road vehicles. 126 However vehicle taxation must be linked to emissions performance, as the United Kingdom's Company Car Tax (CCT) system demonstrates in paragraph 5.1.

<sup>121</sup> Henry Review, above n 38, at 88.

<sup>122</sup> Australian Government, Treasury, "Tax Expenditure Statement," (2008) Chapter 6, D24 Application of Statutory Formula to value car benefits at 105.

<sup>123</sup> Parliament of Australia, Senate Committee for Rural and Regional Affairs and Transport, above n 41, at para 5.62.

<sup>124</sup> Australian Government, "Budget 2011-2012: Fringe benefits tax - reform of the car fringe benefits rules" sighted at http://www.aph.gov.au/library/pubs/RP/BudgetReview2011-12/ CarFBT.htm#\_ftn2 accessed on 25 May 2011.

<sup>125</sup> W. Swan, Treasurer, 'Budget Measures Budget Paper No. 2 2011-2012' at 23 sighted on http:// www.aph.gov.au/budget/2011-12/content/download/bp2.pdf accessed on 26 May 2011.

<sup>126</sup> The Australian Transport Council and the Environment Protection and Heritage Council, "Vehicle Fuel Efficiency Working Group" above n 114 at 15.

# 5 Proposal to link the car FBT concession to vehicles' emissions

To address the shortcomings of the current FBT system and encourage taxpayers to choose low emission vehicles, it is recommended that the taxable value of a company's motor vehicle be linked to that vehicle's CO2 emissions, that is, the lower the vehicle's carbon emissions, the lower the tax liability. This method adopts the 'polluter pays principle', 127 and supports environmental policy mechanisms such as the CPRS.

This paper now considers in some detail the reform of the United Kingdom's company car tax system, which has linked the tax concession to a vehicle's environmental performance. This reform has been held out as the model of 'potential practice' for other European Union member nations.  $^{128}$ 

# 5.1 Taxable value determined on carbon dioxide emissions – UK experience

In meeting the United Kingdom's 1997 Kyoto Protocol commitments to reduce the nation's emissions under the United Nations Framework Convention, the UK Labour government announced a 'Statement of Intent on Environmental Taxation' setting out the government's objective of reforming the taxation system by shifting the burden of taxation from 'goods' to 'bads', to encourage innovation in meeting higher environmental standards, and create a cleaner environment for the benefit of everyone. The new tax system would encourage behavioural change by internalising environmental costs under the 'polluter pays' system and signal to taxpayers the need to adopt environmentally sustainable practices. In 1999, the UK Government announced it would reform the company car tax system by linking the company car tax to a vehicle's CO2 emissions. In the reform took effect in April 2002, providing plenty of lead-time for car manufacturers to make necessary adjustments to the production of their vehicles.

B.J. Richardson, K.L. Chanwai, "The UK's climate change levy: Is it working?" Journal of Environmental Law (2003) – Oxford University Press, at para 2.1. The 'polluter pays' principle removes hidden subsidies that gave an unfair competitive advantage to polluting industries. This concept was advanced in the 1970s by the Organisation for Economic Cooperation and Development (OECD).

<sup>128</sup> Commission to the Council and the European Parliament, "Taxation of Passenger cars in the EU – Options for Actions at National and Community Levels", COM (2002) 0431.

<sup>129</sup> House of Commons "UK the 1997 Statement of Intent on Environmental Taxation" Research Paper 09/86 sighted at http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/231/23108.htm accessed on 28 February 2011.

<sup>130</sup> Richardson, Chanwai, above n 127, at para 2.1.

<sup>131</sup> Department for Transport 'The Future of Transport – White Paper Released on 20 July 2004', para 10.09, sighted on http://webarchive.nationalarchives.gov.uk/+/http://www.dft.gov.uk/about/strategy/whitepapers accessed on 1 March 2011.

The UK Government launched its 'Powering Future Vehicles Strategy' in July 2002, setting challenging targets to reduce transport emissions by promoting the development and uptake of clean, low carbon vehicles (defined as emitting 100 g of CO2 per km or less) and ensuring the full involvement of the UK automotive industry in the new technology. To support this transition, the Government set a target that low carbon cars should represent 10 per cent of all car sales by 2012. 132 To achieve this target, the Government reformed the CCT "to provide financial incentives for employers and company car drivers to choose cars which produce lower levels of CO2 emissions "133

In 2003, the Energy White Paper said that the United Kingdom would primarily reduce emissions through fiscal incentives and technological advancement. 134 The Government claimed that by linking the CCT to a car's CO2 performance, it was encouraging car buyers to buy lower-carbon vehicles.<sup>135</sup> An evaluation of the CCT tax was made by the UK Government in 2004 and 2004, monitoring the impact of the CCT system on car buyers' choice, as discussed in paragraph 5.1.2.

### 5.1.1 United Kingdom's company car tax system prior to 2002

Table 7 shows that prior to April 2002 the UK company car taxation system was similar to the Australian FBT system, where the taxable benefit was calculated by applying a statutory fraction to the list price of the car which was determined by the car's annual level of business mileage for the year. Again, taxpayers were encouraged to increase kilometres travelled for the purpose of paying less tax. 136

| Business Miles  | % of list price |
|-----------------|-----------------|
| Less than 2,500 | 35%             |
| 2,500 to 17,999 | 25%             |
| 18,000 or more  | 15%             |

Table 7: UK Statutory Rates for Business Miles travelled

# 5.1.2 Company Car Tax Reform from April 2002

The reform of the CCT maintained the above tax percentages of 15 per cent to 35 per cent that were applied to the list price of the cars, with an upper limit of 80,000

<sup>132</sup> B Lane and S Potter, above n 29, para 1.0.

<sup>133</sup> B Lane and S Potter, above n 29, para 1.0. Inland Revenue, Report of the evaluation of company car tax reform, Inland Revenue, UK (2004).

<sup>134</sup> Department of Trade and Industry (DTI) 'Our Energy Future - Creating a Low Carbon Economy White Paper' (2003) sighted at http://webarchive.nationalarchives.gov.uk/+/http:// www.berr.gov.uk/files/file10719.pdf.

<sup>135</sup> Department of Trade and Industry (DTI) 'Our Energy Future – Creating a Low Carbon Economy White Paper' (2003), above n 134, para 5.10.

<sup>136</sup> UK Parliament, "Taxing company cars" (2002) at 7 sighted on www.parliament.uk/briefingpapers/RP02-10.pdf accessed on 28 June 2011.

pounds. However, the mileage thresholds in the above system were replaced with a range of approved CO2 emissions for the car, rounded to the next 5g/km. <sup>137</sup> The lowest tax rate of 15 percent applied to the lowest emission threshold shown in Table 8, and for each 5g/km of CO2 emissions that exceeded this threshold, the percentage charge increased by 1 per cent until the level reached a maximum of 35 per cent, currently at 240g/km. <sup>138</sup>

Progressive tightening of the rates has occurred since the reform measure was introduced in 2002, encouraging employees and employers to purchase and lease the lowest emitting cars as shown in Table 8. <sup>139</sup> That is, Table 8 shows the low tax rate threshold commenced at 165g/km in the 2002-2003 year, which was progressively reduced to a lower rate of 99g/km in the 2012-2013 year, and a nil percentage rate for those vehicles emitting no emissions, being applicable only for the next 5 years from 6 April 2010.

Table 8: CO2 Emissions figures for UK car tax

| `               |                |   |
|-----------------|----------------|---|
| Tax Year        | CO2 Charge (%) | Co2 emissions (g/km)                                |
| 2002-03         | 15             | 165   |
| 2003-04         | 15             | 155   |
| 2004-05         | 15             | 145   |
| 2005-06, 07, 08 | 15             | 140   |
| 2008-2009       | 15             | 135   |
| 2009-2010       | 10<br>15       | 120<br>135  |
| 2010-2011       | 0<br>5<br>15   | 0 (powered by electricity)<br>75<br>130             |
| 2011-2012       | 0<br>15        | 0 (applies for 5 years from<br>6 April 2010)<br>125 |
| 2012-2013       | 0<br>10        | 0<br>99   |

<sup>137</sup> HM Revenue & Customs, "Report on the interaction between company cars, employee car ownership scheme cars and mileage allowance payments" (2008) at 34.

<sup>138</sup> HM Treasury, "Rev 6 Protecting the Environment: Reform of the Company Car Taxation" (2000) sighted at http://www.hm-treasury.gov.uk/bud\_bud00\_pressrev6.htm.

<sup>139</sup> HM Treasury, 'Company Car Tax' sighted at http://www.hm-treasury.gov.uk/d/junebudget\_ chapter2.pdf.

The following additional discounts or surcharge apply to influence the employee or employer to choose the lowest emitting vehicle by either increasing or decreasing the above CO2 charge, depending on the type of fuel used<sup>140</sup>:

- Diesel cars incur a 3 per cent surcharge to reflect higher levels of harmful local air pollutants such as particulates and nitrous oxides;
- This surcharge is waived if the diesel cars meet the Euro IV emissions standards (a measure of cleanliness set down in an EU-wide directive) before EURO IV standards became mandatory from 1 January 2006 onwards:
- Discount of 2 per cent to run on LPG or compressed natural gas; 3 per cent for hybrid electric; and
- Discount of 6 percent applies for electric only cars.

Further tightening of the above discounts and surcharges apply from 6 April 2011, to encourage an additional behavioural shift to low or nil carbon emitting vehicles<sup>141</sup>:

There will be no longer any reductions for alternative fuels (hybrids, bi-fuels and cars manufactured to run on "E85":

Diesel surcharge will apply to all diesels; and

The 80,000 pounds limit for the price of a car for car benefit purposes will no longer apply.

In applying the above CCT rates to the example in Table 1, the taxable value for a company car worth \$50,000 will vary depending on the fuel type and the level of CO2 emissions, as shown in the following table:

<sup>140</sup> HM & Customs, "Report on the Evaluation of the Company Car Tax Reform; Stage 2"(2006) at 20 www.hmrc.gov.uk/budget2006/company-car-evaluation.pdf.

<sup>141</sup> HM Revenue & Customs, "Forthcoming changes to the car benefit rules" sighed at http://www. hmrc.gov.uk/cars/rule-changes.htm accessed on 13 March 2011.

| Fuel Type                | CO2 Emissions<br>(g/km) | Percentage of<br>car's price to be<br>taxed at 2008 CO2<br>emissions charge<br>rates | Taxable Value<br>\$ |
|--------------------------|-------------------------|--|---------------------|
| Petrol                   | 240                     | 35   | 17,500              |
| Diesel                   | 162                     | 22   | 11,000              |
| Diesel ultra low sulphur | 162                     | 19   | 9,500               |
| Electric car             | 0                       | 9  | 4,500               |
| Hybrid                   | 120                     | 12   | 6,000               |
| Gas                      | 145                     | 13   | 6,500               |

Table 9: Company car tax calculation using UK CO2 Emissions figures 142

Table 9 shows that the highest taxable value of \$17,500 will apply if a company car fuelled with petrol emits 240g of CO2 per kilometre. Large tax savings can be made if the taxpayer chooses an electric vehicle or hybrid. Obviously, the UK CCT will be a crucial factor in determining an employee's choice of car, as he/she would be keen to choose a vehicle that reduces tax costs while at the same time provides a car suitable for private as well as business use. 143

The HM Revenue & Customs (HMRC) closely monitored the impact of the CCT reform by commissioning two evaluations on the reform in its first year (2003) and its third year (2004). The first stage of the CCT evaluation (Stage 1) was published in April 2004, and assessed the effectiveness of the reform for the first twelve months.

The second stage evaluation report was released by The HM Revenue & Customs (HMRC) in March 2006, providing a comprehensive report on the findings of the evaluation which examined the effectiveness of the reform and assessed whether it reached the objectives of company car tax reform since being introduced in 2002.144 The report found:

The reform is encouraging a substantial number of people to choose cars with lower CO2 emissions. Survey results found around 60 per cent of company car drivers who had a choice of company car were influenced by the CCT reform and chose cars with lower CO2 emissions;

<sup>142</sup> Calculation of CO2 charge: If the vehicle CO2 emissions are 240g/km, then the percentage of the car's value to be tax, is 240g CO2/km less approved emissions threshold of 140g CO2/km equals 100g CO2/km that exceeds the threshold. The 15% CO2 charge is increased by 1 percent for each 5g/km of CO2 emissions, which equals 20%, which equals a total CO2 charge of 35%.

<sup>143</sup> B. Lane and S. Potter, above n 29, para 4.2.

<sup>144</sup> HM & Customs, "Report on the Evaluation of the Company Car Tax Reform; Stage 2"(2006), above n 140.

- When drivers opted out of company cars they usually chose higher polluting vehicles with higher emissions of 5g/km on average than the company cars they replaced;
- A significant reduction of 400,000 company cars from around 1.6 million in 1999 at the time when the reform was announced to 1.2 million in 2005. The company car tax reform was cited as the major reason for employers and employees opting out of company cars. Some of the other reasons given were that employees wanted a different type of car from that which the employer was willing to offer as a company car, and that company cars were no longer considered essential to the needs of an employer's business;
- At least 44 per cent of employers had considered no longer providing company car benefits;
- Many who opted out of the benefit chose to receive additional cash and pay tax. The extra income tax on extra cash paid when employees stopped having company cars offset the reduction in income tax on company cars. The estimated reduction in income tax for each year up to 2005/06 is estimated to be under 5 per cent of the total amount of tax collected for company car benefits for 2002/2003;
- The survey indicated that 50 to 60 per cent of company cars changed to diesel which has lower GHG emissions than petrol (2002: 26 per cent), forecasted to rise to 60 to 70 per cent over the next few years;
- Significant reductions in CO2 emissions from cars of 0.2 to 0.3 Mt CO2-e for 2005, projected to increase to 0.65Mt Co2-e in 2010, with projected yearly reduction of 0.4 to 0.9 Mt Co2 in the long run to 2020. This is about a 1 per cent cut of all UK car CO2 emissions; and
- Unnecessary business travel reduced by 300 to 400 million business miles from April 2002 to March 2003, with a reduction in traffic congestion.

The UK company car tax reform has been successful in not only reducing unnecessary kilometres driven, but also encouraging a substantial number of people to choose company cars with low emission. Since the introduction of the reform in 2002, the average CO2 emissions on all new cars sold in the UK have dropped from 174.7g/ km to 144.5g/km in 2010.<sup>145</sup> The 'over purchasing' of new company cars under the former CCT system is 29 per cent lower than in 2005 when the registration of new company cars was 1.2 million, which dropped from 1.6 million employees receiving car benefits at the time the reform was announced in 1999. 146 However, the uptake of higher emitting vehicles by employees opting out of company cars highlights the

<sup>145</sup> J. Potter, 'UK Company Car Tax Revised' sighted at www.foes.de/pdf/CCT\_Potter.pdf accessed on 13 March 2011.

<sup>146</sup> J. Potter, 'above n 145.

importance for further reform for vehicles that are not under the FBT regime, to ensure employees are encouraged to acquire low emission vehicles privately.

The Stage 2 evaluation report found that the reform of the company car tax in 2002 was an effective measure in significantly reducing CO2 emissions from cars. <sup>147</sup> In particular, the Report showed the CCT system to be an effective measure in strengthening the country's fleet of low emission vehicles, one that will continue to build up over many years as company cars are sold into the private second hand market every three to four years. <sup>148</sup> In time, "privately owned cars in the UK will have on average, lower CO2 emissions because they are former company cars." <sup>149</sup>

Additionally, the CCT system allows the Government to support advances by car manufacturers in vehicle technology and encourages the uptake of low carbon vehicles by tightening the lower rate thresholds to nil for vehicles with no emissions as shown in Table 7. This will thereby encourage a behavioural shift away from the use of fossil fuels. The effectiveness of this measure is evident when comparing the Australian uptake of low carbon vehicles to those in the UK. The NTC findings show the growth of 'green cars' vehicles in Australia (vehicles with emissions that do not exceed 120 g/km) accounted for 0.6 percent of total car sales in 2008, compared to 11 per cent in the United Kingdom. <sup>150</sup> Unlike in the UK, there are no incentives to acquire low carbon vehicles in Australia, which are generally privately purchased and not offered for sale as fleet vehicles as in the UK.

This is reflected in the NTC findings that Australia's new passenger vehicles were high emitting when compared to those of the United Kingdom. That is, the proportion of vehicles sold in Australia with emission under 150g/km was 5 per cent, compared to 50 per cent of all vehicles sold in the United Kingdom which have emissions under 150 g/km. <sup>151</sup> Further evidence of Australia's poor fuel efficiency record is that in 2008, EU-27 vehicles achieved a national average carbon emissions target (NACE) of 145.7g of CO2/km, which represents 33 per cent less emissions than Australia's NACE of 215g CO2/km. <sup>152</sup>

Clearly the above favourable results from the UK's CCT regime should go far to assuage past concerns as to whether the Australian FBT system is an effective

<sup>147</sup> HM Revenue & Customs, above n 140, at 4.

<sup>148</sup> HM Revenue & Customs, above n 140, at 23.

<sup>149</sup> HM Revenue & Customs, above n 140, at 23.

<sup>150</sup> National Transport Commission, above n 50, at 28.

<sup>151</sup> National Transport Commission, above n 50, at 28.

<sup>152</sup> National Transport Commission, above n 50, at 26. European emissions ranged from 138g/km for Portugal to 174g/km for Sweden, which means Australia's average emissions of 215g/km was 55 per cent higher than Portugal's emissions and 23 per cent higher than Sweden's emissions. According to the Federal Chamber of Automotive industries, Australia's NACE target for 2009 was 218.5gCO2/km.

instrument in reducing emission, which has previously been described as "... at best a rough instrument to use to influence behaviour."153

### 5.2 Linking Australia's FBT system to vehicles' carbon emissions

It is unlikely that the UK CO 2 emission charges in Table 8 will be adopted in Australia, considering the CO2 emission charges applied to the base value of the car are higher than the current statutory fraction rates. But, similarly to the UK company car taxation system, Australia can use the existing FBT statutory fractions in Table 1 for consistency, with kilometres travelled being replaced with the vehicle's emissions expressed as the number of grams of CO2 emitted per kilometre, made available from the Green Vehicle Guide. The lowest tax rate of 7 per cent is applied to the lowest emission threshold, which needs to be set by the Government. For the purposes of the example in Table 10, the lowest emission threshold will be set at 145g/km, and will increase by 1 per cent for every 5 g/km of CO2 emissions that exceeds this threshold to a maximum of 26 per cent, being the highest FBT statutory fraction under the current FBT system. A surcharge of 2 per cent could apply to diesel cars unless it meets the Euro IV emissions standards, and the following discounts could apply:

- 1 per cent for cars using LPG or compressed natural gas;
- 3 per cent for hybrid vehicle with CO2g/km of 100 or less; and
- 5 per cent for electric vehicle with no CO2/g/km emissions.

In recalculating the taxable value in Table 1, for a vehicle worth \$50,000, the new taxable value based on the vehicles CO2 emissions will be as follows:

Table 10: Statutory fraction method with new fractions or CO2 Emission Charges

| Fuel Type                | CO2 Emissions<br>(g/km) | CO2 Emission<br>Charges applied to<br>base value of car<br>% | Taxable<br>Value |
|--------------------------|-------------------------|--|------------------|
| Petrol                   | 240                     | 26   | 13,000           |
| Diesel                   | 162                     | 12<br>(additional<br>surcharge of 3%)                        | 6,000            |
| Diesel ultra low sulphur | 162                     | 10   | 5,000            |
| Electric car             | 0                       | 2  | 1,000            |
| Hybrid                   | 100                     | 4  | 2,000            |
| Gas                      | 145                     | 6  | 3,000            |

The above new fractions or the CO2 emission provide for quite low statutory tax rates compared to the single statutory rate of 20 per cent, and effectively provide a significantly greater subsidy to company cars for the purpose of encouraging a behavioural shift to low emission vehicles. In effect, the above CO emission rates are a substantial departure from the current taxation policy discussed in paragraph 6.0, by aligning taxation policy with environmental policy objectives of significantly reducing carbon emissions.

The proposed CO2 emission charges in Table 10 incorporate the 'polluter pays' principle with the highest polluting vehicle bearing the highest tax burden with a taxable value of \$13,000, compared to the lowest emitting vehicles with a taxable value of \$1,000 for an electric vehicle, or \$2,000 for a hybrid.

In Table 1, the highest taxable value under the current statutory fraction formula method was \$13,000 for the lowest kilometres travelled of less than 15,000 kilometres, and the lowest taxable value of \$3,500 was for the highest kilometres travelled in excess of 40,000 kilometres for the year.

Under the single statutory rate of 20 per cent, the taxable value is \$9,600 regardless of kilometres travelled. This is \$3,400 less than the taxable value shown in Table 10 for the highest polluting vehicle with emissions of 240g of CO2 per kilometre.

A comparison of the three different methods of calculating the taxable value shows the UK CCT system is highly favourable, and provides the strongest incentives for employees and employers to choose the lowest emission vehicle and fuel type to lower the FBT liability. 154 Thus, considerable tax savings can be made if the employee and employer choose the lowest emitting vehicle.

This will address the concern by fleet managers that the current FBT system discourages Fleets from acquiring lower emission vehicles because they are less "financially attractive". 155

# 5.2.1 CO2 emission charges applied to operating cost method

Currently, two-thirds of car benefits are valued under the operating cost method as discussed in paragraph 3.3, which may increase with the adoption of the single statutory rate of 20 per cent applicable to new vehicle contracts entered into after 7.30pm on 10 May 2011. That is, an employee who travels more than 25,000 kilometres per year may request a change to the operating cost method if this method provides a lower FBT liability than under the single statutory rate method, even though the employee will have an additional administrative burden of maintaining a logbook to substantiate car usage. Therefore, if the FBT regime is to provide incentives for a

<sup>154</sup> HM Revenue & Customs, above n 140 at 25. The findings showed that cars had CO2 emissions that were 15g/km lower on average by 2004 since the introduction of the company car tax reform

<sup>155</sup> Australasian fleet Managers Association, above n 66, at 3.

behavioural change to low emission vehicles, then it must also apply to the operating cost method.

For example, applying the same CO2 emission charge rates to a new car costing \$50,000, assuming a business percentage of 50 per cent and operating costs of \$4,000, the taxable value under the operating cost method<sup>156</sup> will be \$8,700<sup>157</sup> to which the same statutory fraction CO2 emission charges discussed in paragraph 5.2.0 are applied as follows:

| Table 11: Applying CO2 emission charges to operating | cost method |
|--|-------------|
|--|-------------|

| Fuel Type                   | Taxable Value<br>without CO2<br>Emission<br>Charge | CO2<br>Emissions<br>(g/km) | CO2<br>Emission<br>Charges<br>applied<br>to taxable<br>value of car.<br>% | CO2<br>Emission<br>Charge | Taxable<br>Value<br>with CO2<br>Charge |
|-----------------------------|--|----------------------------|---|---------------------------|--|
| Petrol                      | 8,700  | 240                        | 26  | 2,262                     | 10,962                                 |
| Diesel                      | 8,700  | 162                        | 10<br>(additional<br>surcharge<br>of 3%)                                  | 1,044                     | 9,744                                  |
| Diesel ultra<br>low sulphur | 8,700  | 162                        | 7   | 870                       | 9,570                                  |
| Electric car                | 8,700  | 0                          | 2   | 174                       | 8,874                                  |
| Hybrid                      | 8,700  | 100                        | 4   | 348                       | 9,048                                  |
| Gas                         | 8,700  | 145                        | 6   | 522                       | 9,222                                  |

For the highest polluting vehicle with emissions of 240 g/km, the taxable value is still more than the taxable value of \$9,600 under the single statutory rate of 20 per cent discussed in paragraph 3.6, but not as high as the taxable value of \$13,000 under the proposed statutory fraction method with CO2 emission charges shown in Table 10. However, the taxable value of the low emission vehicles in Table 11 will not provide significant tax savings to encourage employees to change to a low emission vehicle, particularly when the taxable value of low emission vehicles under the operating cost

<sup>156</sup> S10 of the FBTAA 1986, where the formula used for calculating the taxable value is (C x (100% - BP)) - R, where: C = operating cost of the car, BP = Business percentage; R = Recipients payment.

<sup>157</sup> Taxable value = (operating cost of \$4,000 + deemed depreciation \$9,375 + deemed interest \$4,025) = \$17,400 x (100% - business percentage applicable to the car of 50%)). Deemed depreciation under Sec 11(1) = Cost of vehicle \$50,000 x depreciation rate of 18.75% x 365 days / 365 days. Deemed interest under Sec 11(2) = Cost of vehicle \$50,000 x interest rate of 0.0805 x 365 days / 365 days.

method in Table 11 are higher than under the statutory fraction method with CO emission charges in Table 10.

Furthermore, CO2 emission charges applied to the taxable value of the car benefit will diminish with increased business use, allowing high polluting vehicles a tax concession for vehicle costs, regardless of the vehicles' greenhouse emissions.

Thus, to reform the FBT regime to provide incentives for a behavioural shift to low emission vehicles, it is recommended that the statutory fraction method based on CO2 emission charges should be the only method that applies to car benefits.

### 5.2.2 Henry Report rejects the use of subsidies to reduce vehicle emissions

Despite the success of the UK CCT system in encouraging a behavioural change to low emission vehicles, the Henry Report considers: "individual emissions levels depend not only on the efficiency of the vehicle, but also on other factors, particularly distance travelled, weight carried and driver behaviour." 158 Whilst these factors are likely to contribute to lowering road emissions, the UK King Review states that significant cuts to road emissions will come from improvements in vehicle technology. 159

The Henry Report also rejects the use of subsidies to target vehicle fuel efficiency because it "may reward people who purchase a fuel-efficient vehicle yet travel large distances, and penalise people who purchase a less expensive, less fuel-efficient vehicle, but travel rarely." <sup>160</sup> However, it cannot be guaranteed that people who purchase a less fuel-efficient vehicle will 'travel rarely' and emit less carbon emissions. Nor can it be assured that when the vehicle is sold into the second hand market that the purchaser will 'travel rarely'. Given this, it is more favourable to purchase a fuel-efficient vehicle at the time of acquisition, because the purchaser of an ex-fleet vehicle may have high fuel costs and high emissions over the remaining life of vehicle. 161

Targeting vehicle fuel efficiency as a means of reducing emissions is considered by the Henry Report to be a "blunt instrument" compared to targeting emissions directly by reflecting the cost of carbon emission in fuel prices. 162 Consequently, the Henry Report argues that an emission-trading scheme is the total solution to reduce car emissions, where additional policy measures will not be required. 163 Discussion on whether the CPRS is the 'total solution' in reducing road transport emissions is outside the scope of this paper.

<sup>158</sup> Henry Report, above 109, at 363.

<sup>159</sup> King Review, above 6, at para 2.2.

<sup>160</sup> Henry Report, above n 109, at 363. The Final Report states that taxes levied on second-hand cars 'may encourage premature scrapping of older cars in favour of new cars.'

<sup>161</sup> National Transport Commission, above n 50.

<sup>162</sup> Henry Report, above n 109, at 363.

<sup>163</sup> Henry Report, above n 109, at 362.

Furthermore, the Henry Report also rejects the use of incentives to encourage taxpayers to undertake "environmentally beneficial activities" because it would "impose costs on the whole community through the higher taxes needed to fund them." 164 This means the Henry Report would most likely have rejected reforming the current FBT system on the basis of vehicles emissions, because the Report considers such subsidies as a cost to the community. If this is the case, then it is argued that the current car fringe benefits system and the Henry Reports recommended single flat rate of 20 per cent should be removed because it imposes a cost on the whole community by having to fund a concession that provides no benefit either to the community or the environment, as discussed in paragraph 4.1.

### Impact of the proposed FBT reform on the motor 6 vehicle industry

The Australian motor vehicle producers (MVP) would strongly oppose reforming car FBT concession linked to the vehicles CO2 emissions when the average CO2 emissions from Australian-made vehicles was 264 g/km in January-August 2009, 165 which is above the highest CO2 emissions of 240g of CO2/km shown in Table 10. In effect, most Australian-made vehicles will bear the highest FBT liability. 166

However, it is unlikely that the Australian Government will support a measure that disadvantages the local car industry. This became evident when the 2009 Senate Standing Committee on Rural and Regional Affairs and Transport questioned Treasury on the policy purpose of making FBT cars concessionary. The Committee noted that "Treasury gave an uninformative answer which avoided the question." <sup>167</sup>

The difficulty the Government faces in reforming the car benefit FBT system and significantly reducing road emissions as proposed in paragraph 5.0 is the impact of these measures on the automotive industry and the economy, given that in 2010 the automotive manufacturing industry employed over 53,000 people and automotive exports totalled more than \$2,088 million. 168 It is the largest manufacturing sector in Australia, representing around 6 per cent of Australia's total value added and contributing around 1 per cent of national GDP. 169

- 164 Henry Report, above n 109, at 357.
- 165 National Transport Commission, above n 50, at 21.
- 166 National Transport Commission, above n 50.
- 167 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.63.
- 168 Australian Government, Dept of Innovation, Industry, Science and Research "March 2011 Automotive Update" sighted at http://www.innovation.gov.au/Industry/Manufacturing/ Documents/DIISRManufacturingDataCard.pdf accessed on 27 June 2011.
- 169 Federal Chamber of Automotive Industries (FCAI) "Submission to the Inquiry into Manufacturing in Victoria" (2009) at 2 sighted at http://www.parliament.vic.gov.au/images/ stories/committees/edic/submissions/VMI\_Sub\_58\_FCAI.pdf accessed on 27 June 2011.

However the Australian Motor Vehicle Industry (MVI) has been supported by the Australian Government since 1986, when the Button Plan<sup>170</sup> was introduced to protect the economic viability of this sector.<sup>171</sup> At the time, the statutory formula method under the FBT legislation was being indirectly designed to support the MVI through subsidising vehicle cost. With financial support, the car FBT concessions, import tariffs and quotas on imported vehicles, Australian-made motor vehicles accounted for an estimated 85 per cent of domestic passenger vehicles sales in 1986.<sup>172</sup>

Since the Button Plan, the Australian motor vehicle market has changed dramatically. Rising oil prices, falling import quotas and tariffs from 57.5 per cent in 1984, to 5 per cent from 1 January 2010 opened the market to imports. This has caused a major shift in consumer preference for smaller low fuel consumption vehicles, and a change in preference from locally produced larger vehicles to sports utility vehicles (SUV's). In effect, sales of locally produced passenger vehicles have fallen significantly by more than three quarters from 85 per cent in 1986 to 51 per cent in 1995, 29 per cent in 2004, 19.4 per cent in 2007, 17 per cent in May 2008<sup>174</sup>, and 14.1 per cent in 2010. 175

Consequently, the local car industry would be concerned if the car FBT concession was reformed because over 75 per cent of domestically produced vehicles represent fleet sales to the government and business sector.<sup>176</sup> In these terms, GM Holden expressed their concern to the Henry Review that the operation of the FBT system was vital to the sustainability of the local industry<sup>177</sup> and, "without the car FBT concession there would be little incentive to offer cars as fringe benefit, and employees left to their own devices would be more likely to buy imported vehicles." The same argument was made in the 1999 Ralph Review of Business Taxation when the local car industry argued "... any tightening of the formula would damage its sales and

- 171 Warren, above n 60, at 16.
- 172 Warren, above n 60, at 19.
- 173 Bracks Review, above n 42, at 10. The sports utility vehicles range in size from the Suzuki Vitara and Toyota RAV4 through to the Hummer.
- 174 Bracks Review, above n 42, at 10.
- 175 T. Hagon, :'Â place for local talent' above n 108.
- 176 Bracks Review, above n 42, at 10. The business sector acquired 113,807 (or 56.8 per cent) of Australian made vehicles sales, the government acquired 37,073 (or 19 per cent) of Australian made vehicle sales and private buyers acquired 50,293 vehicles or less than a quarter of Australia made vehicle sales. With declining domestic sales, the industry's sustainability and survival has been reliant on sales of its medium to large six-cylinder vehicle to the Middle East markets, with exports of motor vehicles totalling \$2.9 million and automotive components totalling \$1.7 billion in 2007, 15.
- 177 GM Holden Submission to Henry Review "GM Holden Submission to Australia's Future Tax System Review" Oct 2008, at 5.
- 178 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41 Senate, para 5.63.

<sup>170</sup> The 'Button Plan' is named after the Minister for Industry and Commerce, Senator Button, who was to report on the long term future of the car industry and how to make it efficient. The recommendations proposed by Senator Button are known as the 'Button Plan'.

encourage employers to choose cheaper, imported cars". 179 The shift to imported cars, of course, is already happening without any reform to the car FBT concession.

The Federal Chamber of Automotive Industries (FCAI)<sup>180</sup> submission in March 2009, urged the Review Panel to carefully consider the implications of their recommendations to the Australian MVI and the effect on the purchasing decisions by business if there are changes to the FBT Statutory Formula method. 181

GM Holden's submission to the 2008 'Public Discussion Paper on Vehicle Fuel Efficiency' said that the "long term future of the industry depended on manufacturers having strong demand for locally produced vehicles." Thus, the current FBT car concession remains to support the local car industry, which only represents 14 per cent of all car sales.183

The Australian Government has continued to support the Australian MVI by announcing in 2008 that it would extend its financial support to 2020 by a further \$6.2 billion over 13 years or \$477 million per year. 184 The OECD reported in its 2010 economic survey of Australia that this additional assistance made the total level of subsidies to the Australian automotive industry the second highest in the OECD on a per capita basis. 185 In fact, the OECD reported that justification for more assistance to distressed industries "has no solid empirical evidence" and that such subsidies "hinder structural adjustment and the reallocation of resources in the economy." 186 It is outside the scope of this paper, however, to discuss the financial support provided by the government.

The 2009 Senate Standing Committee in Rural and Regional affairs and Transport believed that support to the Australian MVI extended to the car FBT concession. 187 The Committee said that "it appears that the concessionary car FBT at about \$1.7 billion per year, considered as assistance to the car industry, is by far the largest

<sup>179</sup> Ralph Committee, above n 77, at 224.

<sup>180</sup> The FCAI is an industry organisation that represents vehicle manufacturers and importers of passenger vehicles, light commercial vehicles and motorcycles in Australia.

<sup>181</sup> FCAI, "Submissions to the Review of Australia's Future Tax System" (March 2009) at 7 sighted at www.fcai.com.au/.../submission-to-the-review-of-australia-s-future-tax-system---march-2009

<sup>182</sup> GM Holden, "GM Holden Submission to the Public Discussion Paper on Vehicle Fuel Efficiency: Potential measures to encourage the uptake of more fuel efficient, low carbon emission vehicles" (November 2008), at 18.

<sup>183</sup> Bracks Review, above n 42, at 10. In 2007, 327,984 vehicles were produced: 201,173 (or 61 per cent) vehicles were sold domestically and 126,811 (or 39 per cent) were exported.

<sup>184</sup> Borthwick, National Transport Council, above n 32.

<sup>185</sup> OECD, "OECD Economic Survey, Australia" (2010) at 67, sighted on http://resources.news.com. au/files/2010/11/15/1225953/995883-101116-aes.pdf accessed on 27 June 2011.

<sup>186</sup> OECD, above n 185 at 67.

<sup>187</sup> Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.65.

element of government assistance to the industry."<sup>188</sup> The Committee described this as "a subsidy of at least \$10,000 to secure a consumer's decision to buy Australian instead of imported."<sup>189</sup> The Committee noted, "at least it should be stressed – the true figure may be much higher, since it depends on how much the concession actually influences people's behaviour (the more people who buy Australian anyway, the greater is the subsidy taken over each of the buyers whose behaviour is influenced)."<sup>190</sup>

When questioned by the Committee, the Australian Government was reluctant to admit that "the purpose of the concession is to support the Australian car industry (no other purpose has been suggested)." <sup>191</sup> This led to the Committee making the following recommendation in relation to the application of the statutory formula method: <sup>192</sup>

- the Government should state the purpose of making the tax concessionary (noting that whether the tax should be concessionary, and whether there should be a statutory formula for the sake of easy compliance, are different questions);
- the Government should investigate and report on how well the concession is achieving its purpose; and
- the Government should investigate and report on what the likely effects on consumer behaviour would be if the concessionary aspect of car FBT was reduced or removed.

Without reforming and linking the FBT concession to the vehicles emissions, the MVI has been allowed to continue manufacturing vehicles that have emissions 40 to 50 per cent higher than international best practice of 163 g/km in 2007.<sup>193</sup> According to the NTC, this is directly attributable to Australian-made vehicles being all large vehicles and that "therefore emissions are higher."<sup>194</sup>

- 188 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.68.
- 189 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, para 5.68. The Report continues to state: 'At least should be stressed the true figure may be much higher, since it depends on how much the concession actually influences people's behaviour (the more people who buy Australian anyway, the greater is the subsidy taken over each of the buyers whose behaviour is influenced). This seems to be the unknown."
- 190 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.68.
- 191 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.64.
- 192 Parliament of Australia: Senate Standing Committees on Rural and Regional Affairs and Transport, Inquiry, above n 41, at para 5.92. Recommendation 8.
- 193 Mr Borthwick, National Transport Council, above n 32.
- 194 National Transport Council, above n 50, at 21.

The local car manufacturers Ford and GM Holden recorded the highest corporate CO2 emissions for the top 15 makes by sales. <sup>195</sup> For example, the NTC report showed Holden's average emissions remained unchanged for the period 2005 to 2008<sup>196</sup> and had the highest average emissions of 270 g/km with no improvement since 2005. 197 In fact, between 2005 and January-August 2009, Holden Commodore delivered an increase of 3 per cent in average emissions. 198

In effect, not only has the current FBT system failed to reduce road transport emissions, but it has allowed the local motor vehicle industry to continue manufacturing fuel inefficient, high emitting vehicles at cost to the environment and community as well as to the detriment of the industry, by failing to rise to the global challenge of significantly reducing vehicles emissions. This is in stark contrast to the situation in the UK, where the demand for low emission vehicles increased after the reform of the UK CCT system, leading UK car manufacturers to introduce more diesel models than would otherwise have been the case. 199 200

Clearly, if Australia reforms the current FBT system by linking the concession to vehicles' CO emissions, it will provide a financial incentive for employers and employees to choose cars with lower levels of CO2 emissions. According to the NTC, if Australia can achieve the international best practice figure of 163g/km, the following reduction in emissions may result:201

- 16.5 million tonnes fewer emissions over the vehicle life, considering that Australia's transport sector produced 80.6 million tonnes of CO2 emissions in 2005; and
- An estimated \$9 billion in savings from fuel (assuming a fuel price of \$1.20 cents per litre) for Australian motorists over the vehicle life.

Like the UK, the Australian MVI must make the transition to low emission vehicles and not rely on the current FBT system for its existence and survival. Currently, Government's reluctance to reform the FBT car concession in an effort to protect the local MVI (which only represents 14 per cent of new car sales) will benefit mostly the

<sup>195</sup> National Transport Council, above n 50, at 18. Ford average vehicle CO2 emissions for the period Jan to Aug 2009 was 252g/km, and Holden was 245g/km.

<sup>196</sup> National Transport Council, above n 50, at 20.

<sup>197</sup> National Transport Council, above n 50, at 21.

<sup>198</sup> The NTC reported that Australian-made vehicles by Toyota had the lowest emissions of Australian made National Transport Council, National Transport Commission, (NTC) "Carbon Emissions from New Australian Vehicles" vehicle manufacturers with emissions of 231 g/km in Jan-Aug 2009, a 6 per cent improvement since 2005; Ford was the second with emissions of 268 g/km in 2009, a 8 per cent reduction since 2005.

<sup>199</sup> HM & Customs, "Report on the Evaluation of the Company Car Tax Reform; Stage 2" (2006), above n 140, at 24.

<sup>200</sup> Bracks Review, above n 42, at 9. In 2006, Australia local car manufacturers produced 388,985 vehicles, compared to 1.8 million vehicles produced in the UK.

<sup>201</sup> Mr Borthwick, National Transport Council, above n 32.

importers of high emitting vehicles, making it difficult for Australia to significantly reduce road emissions.

# 7 Conclusion

This paper has identified that a significant reduction in road transport emissions can be achieved through improvements in vehicle technology, and that this is dependent on increasing the supply of and demand for low emission vehicles. This will only occur, of course, through Government support by introducing fiscal measures that provide incentives for consumers to make an informed and responsible choice in purchasing a low carbon vehicle.

It is argued, then, that reforming the current car benefit FBT system on the basis of vehicles' carbon emissions is an effective instrument in encouraging behavioural change toward low emission vehicles, as evidenced in the UK with the introduction of the company car taxation system in 2002. This is particularly important given that over half of all new vehicles acquired are government and business fleet vehicles which are sold every two to three years onto the second hand market, and can remain on road for an average of 10 years. Therefore the FBT car subsidy can be seen as an effective measure in influencing the type of vehicle entering the market, and building up the country's fleet of low emission vehicles.

However, many submissions for reform of the FBT system were more concerned with reducing vehicle use and excessive kilometres travelled rather than encouraging the acquisition of low emission vehicles. For example, the 2009 Henry Report recommended a flat 20 per cent statutory rate regardless of kilometres travelled, which would reduce the incentive to increase kilometres travelled in order to reduce tax liability.

With the Australian Government adopting the recommendation of the Henry Report for a flat 20 per cent statutory rate, the perverse subsidy still remains and continues to have other harmful environmental effects such as distorting employees' choices toward larger, high emitting vehicles, because the subsidy lowers the costs of such vehicles. Therefore, it is argued that if the car FBT concession is a cost to the community in lost revenue each year, then this tax concession should benefit the community by increasing Australia's fleet of low emission vehicles. Linking the car FBT concession to vehicles' emissions will make the taxation measure environmentally sustainable by removing the incentive for unnecessary travel and encouraging behavioural change towards low emission vehicles. This is imperative if Australia is to significantly reduce its road transport emissions.