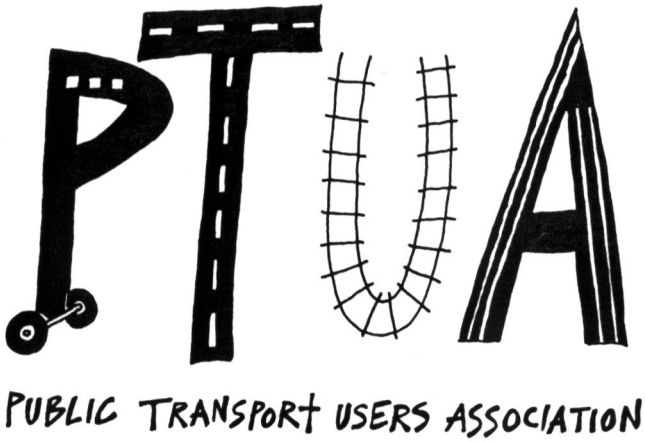
Overview of How Australia's Tax System Compares Internationally



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Contents

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Introduction

We do not propose to go into great detail on the structure of the tax system in Australia, however we do believe any reforms should be guided by these principles:

- economic sustainability,
- environmental sustainability, and
- social equity.

We are supportive of a progressive system of taxation and see a strong need to lower the extremely high effective marginal tax rates faced by many people on low incomes.

Many commentators suggest that Australia has undue reliance on income tax. Without directly commenting on such views, we suggest that the following proposals offer sensible options to broaden the tax base and simultaneously achieve improved economic, social and environmental outcomes. In doing so, opportunities may arise to lower or remove other taxes.

Summary of Recommendations

1. Introduce a broad-based carbon tax or auction of tradeable carbon emission permits to internalise the cost of greenhouse emissions.

2. Reintroduce automatic indexation of fuel excise incorporating a “catch-up” provision to progressively raise it to the OECD median.

3. Remove GST from public transport fares.

4. Eliminate fuel subsidies provided by all tiers of government and apply financial penalties to jurisdictions that fail to eliminate fuel subsidies.

5. Encourage all jurisdictions to shift the calculation of vehicle charges to distance-based and efficiency-based methodologies.

6. Abolish the FBT exemption for minor, infrequent and irregular private use of commercial vehicles or strengthen the substantiation requirements.

7. Replace current FBT statutory fraction calculation with 5,000km business use assumption.

8. Replace 'on-premises' FBT concession for employee car parking with concessional allowance applying to all modes of employee transport.

9. Public transport benefits provided to employees should be exempted up to at least the level of the car parking threshold provided for in s.39A(2).

10. Broaden the taxi travel FBT exemption to include comparable travel by public transport.

Carbon pricing

The introduction of a broad-based carbon tax or auction of tradeable carbon emission permits could provide several billion dollars per annum to fund the reduction or elimination of other taxes. Carbon pricing could provide a powerful market signal to reduce greenhouse emissions and would greatly assist Australia's compliance with the requirements of the Kyoto Protocol as well as enable Australian businesses to trade carbon credits internationally. On top of enabling a revenue stream that could be used to finance adjustment schemes or reductions in other taxes, an auction of emission rights (rather than administrative allocation) would ensure greatest allocative efficiency across the economy.

Australia is one of very few industrialised countries outside the USA without actual or planned carbon pricing mechanisms. For example, the European Union introduced an emissions trading scheme last year and schemes are being investigated in Korea, Norway, Canada and New Zealand. Trading schemes are also being investigated by state governments in the USA and Australia.

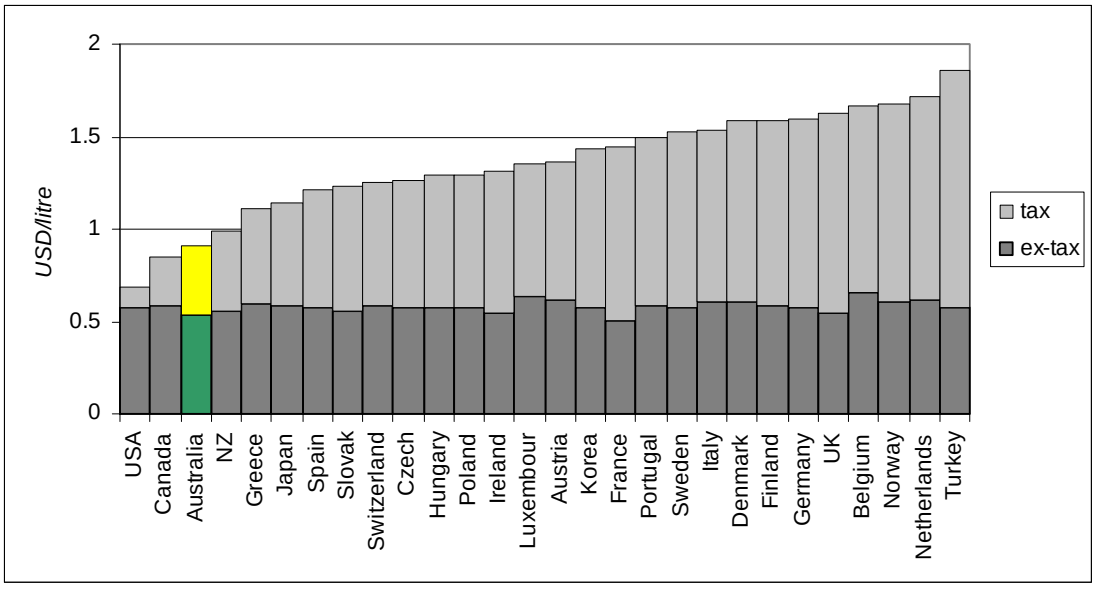
Recommendation 1: Introduce a broad-based carbon tax or auction of tradeable carbon emission permits to internalise the cost of greenhouse emissions.

Fuel taxation

> "Australian taxes on fuel are low by world standards."
> Page 94, *Securing Australia's Energy Future*, released by Prime Minister John Howard, 15 June 2004

We are in full agreement with the above statement. Figure 1 below demonstrates the low level of fuel excise in Australia by international standards.

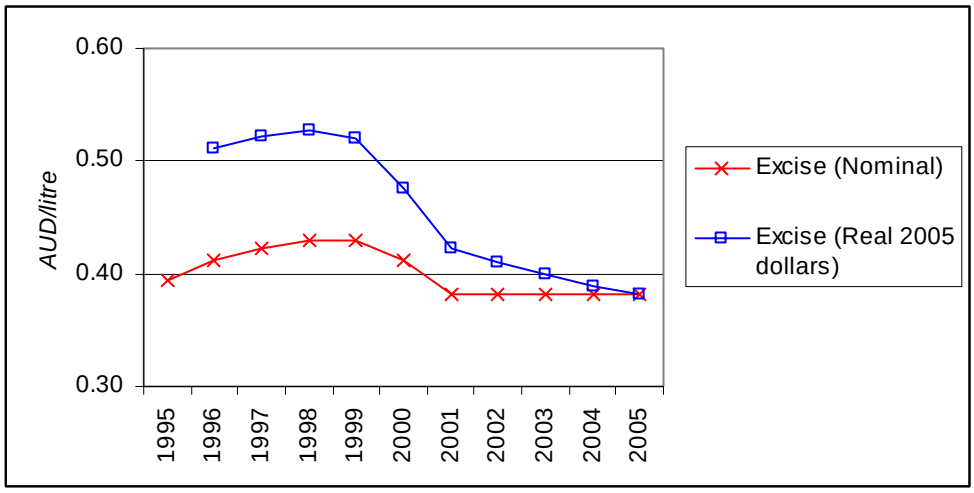
Figure 1: Unleaded gasoline prices and taxes



Source: International Energy Agency

Even though fuel excise in Australia is already very low by world standards, the removal of automatic indexation in 2001 is causing it to continue falling in real terms as shown in Figure 2 below.

Figure 2: Real and Nominal fuel excise in Australia



Source: International Energy Agency

Fuel taxation is an effective means of reducing energy consumption and traffic[1]. In fact, the reduction of fuel taxation in response to rising fuel costs has been soundly criticised as counter-productive due to the distorting effect it has on market signals[2]. In view of this, we strongly recommend against the reduction of excise or GST on fuel. Given the disproportionate negative impact on public transport prices of tax reforms introduced in 2000[3], we believe there is a much stronger case for removing GST from public transport fares.

In contrast, steadily increasing fuel taxation would encourage more efficient transport practices and provide funding to increase the coverage of rail freight and public transport infrastructure and services. Given that nearly three quarters of motor vehicle travel occurs in urban areas (see Figure 3), and that the highest per capita petrol consumption takes place in highly urbanised and densely populated states such as Victoria, there is significant potential to encourage more sustainable transport practices through fuel taxation. Furthermore, given the large scale of the "road deficit" (see Appendix A), we believe there is significant scope to increase the level of cost recovery from road users.

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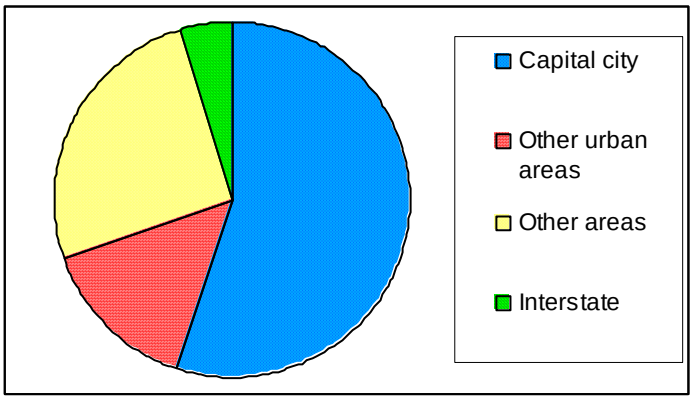
[1] Litman, T, 2005, *Appropriate Response to Rising Fuel Prices*, Victoria Transport Policy Institute, Victoria B.C., available from: http://www.vtpi.org/fuelprice.pdf
Fulton, L. & Noland, R., 'Pricing and taxation-related policies to save oil in the transport sector', *Energy Prices & Taxes: Quarterly Statistics*, 2005 Edition, International Energy Agency, Paris

[2] ibid.

[3] Turton, H. & Hamilton, C., 1998, *The GST Package and Air Pollution: The impact of proposed indirect taxes changes on atmospheric emissions*, The Australia Institute, Canberra
Hamilton, C., Denniss, R. & Turton, H., 2002, *Taxes and Charges for Environmental Protection*, The Australia Institute, Canberra

Figure 3: Motor vehicle kilometres travelled 2004



Source: Australian Bureau of Statistics

Recommendation 2: Reintroduce automatic indexation of fuel excise incorporating a "catch-up" provision to progressively raise it to the OECD median.

Recommendation 3: Remove GST from public transport fares.

Fuel rebates

The actual levels of fuel taxation should be viewed in light of various rebates provided at State and Commonwealth levels such as Queensland's Fuel Subsidy Scheme, Victoria's petroleum subsidies and the Commonwealth's Diesel and Alternative Fuels Grants Scheme and Fuel Sales Grants Scheme. These perverse subsidies act to increase travel and therefore increase energy consumption, vehicle emissions and congestion.

All levels of government should move to eliminate these costly subsidies, and the Commonwealth Grants Commission should reduce State and Territory funding in proportion to the level of fuel subsidisation in each jurisdiction.

Recommendation 4: Eliminate fuel subsidies provided by all tiers of government and apply financial penalties to jurisdictions that fail to eliminate fuel subsidies.

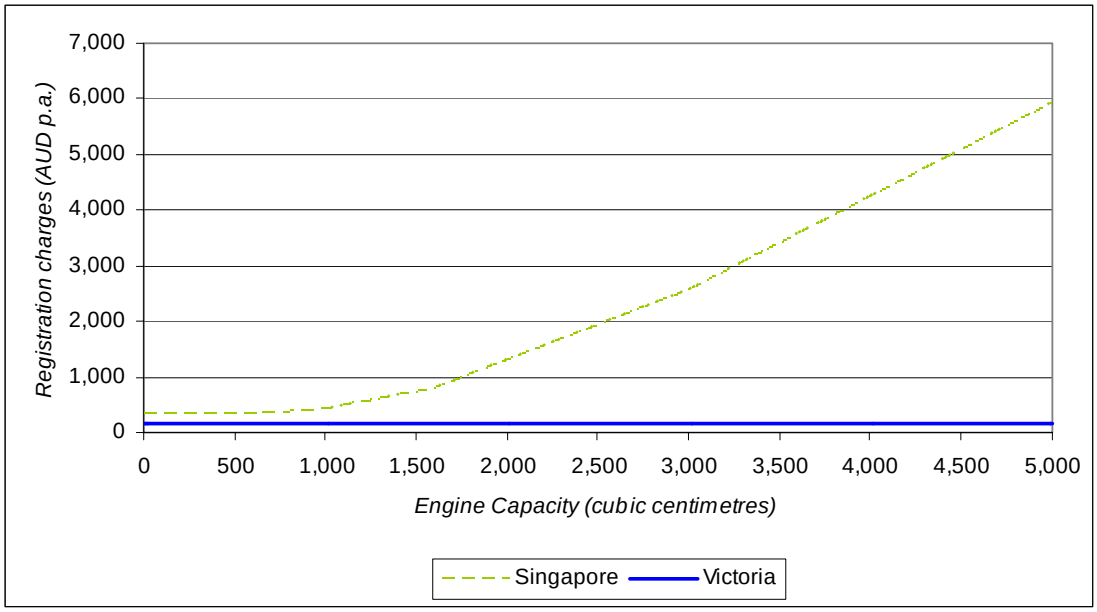
Distance-based and efficiency-based charges

While fuel taxation is effectively a charge that varies according to distance and energy efficiency, a range of other government charges are amenable to more explicit distance-based application. For example, registration fees and compulsory third party insurance schemes could be levied according to distance travelled, enabling motorists

that restrict their travel to benefit from lower vehicle charges[4]. This shift in pricing would reduce energy consumption, vehicle emissions and traffic congestion[5].

Registration charges that vary according to engine size have also proven effective in reducing energy consumption and vehicle emissions[6]. As a rule, vehicle registration charges in Australia are low compared to other OECD countries, as exemplified in Figure 4 below. In light of this, there is scope to increase charges according to distance travelled and/or engine size and thereby provide funding to increase the coverage of rail freight and public transport infrastructure and services.

Figure 4: Annual registration charges (excluding compulsory insurance)



Sources: VicRoads[7], Singapore Land Transport Authority[8]

Recommendation 5: Encourage all jurisdictions to shift the calculation of vehicle charges to distance-based and efficiency-based methodologies.

Fringe benefits tax

Fringe Benefits Tax (FBT) is an important source of revenue for the Commonwealth government as well as a key means of ensuring that individuals do not derive benefits from their employment that fall outside the scope of the tax system. To the extent that recipients of employment fringe benefits receive concessional treatment under the *Fringe Benefits Tax Assessment Act 1986* (the Act), this effectively (even if not technically) represents a transfer or subsidy to them from other tax payers and should be recognised as such to ensure an equitable and transparent tax system.

[4] Litman, T., 2005, *Distance-Based Pricing*, Victoria Transport Policy Institute, Victoria B.C., available from: http://www.vtpi.org/tdm/tdm10.htm
[5] PTUA, 2005, *Submission to VCEC Inquiry into Managing Transport Congestion*, PTUA, Melbourne
[6] Inland Revenue (UK), 2004, *Report on the Evaluation of Company Car Tax Reform*, Inland Revenue, London
[7] http://www.vicroads.vic.gov.au/vrne/vrne5nav.nsf/FirstChild/-21A36A27951CB8D8CA2571330001B389
[8] http://www.lta.gov.sg/motoring_matters/motoring_vo_tax_pte.htm

Subsidies, however they are structured, tend to have the effect of lowering the cost of a good or service relative to substitutes, thus increasing consumption beyond the most economically rational and efficient level and reducing overall welfare. If such a subsidy has negative economic, environmental and/or social consequences it can be referred to as a "perverse subsidy". As perverse subsidies have no economic, environmental or social justification, the goal should be to eliminate them from the tax system.

Perhaps the most common form of significant fringe benefit is a company car. Due to the ease with which motor vehicles can be included in a remuneration package whilst retaining at least some access to input tax credits and tax deductions through the various methodologies applicable to motor vehicle fringe benefits, they have become an almost ubiquitous part of employee salary packaging arrangements.

Whilst we do not dispute the commercial justification of some motor vehicle use by employees, the relative ease by which motor vehicle fringe benefits can be provided to employees whilst attracting concessional treatment under the Act provides a perverse subsidy to excessive vehicle and resource use and exacerbates air and noise pollution and traffic congestion. It is worth noting that around 40% of peak hour traffic is company cars. Even a relatively small shift in this traffic from car to public transport would have a significant impact on congestion and vehicle emissions.

In order to reduce the perverse subsidy to private motor vehicle use, a priority for Fringe Benefits Tax reform should be to align motor vehicle expense deductibility more closely with business use, rather than total use, and to ensure that motor vehicles are treated no more favourably than substitutes, i.e. other modes of transport such as public transport and cycling.

There is strong evidence from overseas that policies that encourage use of modes of transport other than the private car can achieve significant reductions in pollution and traffic congestion. This evidence informs the following recommendations.

Car fringe benefits

Exempt car benefits

Section 8 of the Act provides an exemption from FBT for "minor, infrequent and irregular" private use of commercial vehicles. The level of private use is frequently substantiated by a written declaration from the employee. Anecdotal evidence indicates that in practice this provision is widely abused and employees make significant private use of the vehicle. Furthermore, the availability of this exemption influences vehicle purchasing decisions away from relatively fuel efficient passenger cars towards heavier, less fuel efficient vehicles.

Given these deficiencies, this exemption should only be available where the level of private use is substantiated by a logbook or a verifiable system of enforcement by the employer that limits private use to a genuinely "minor, infrequent and irregular" level.

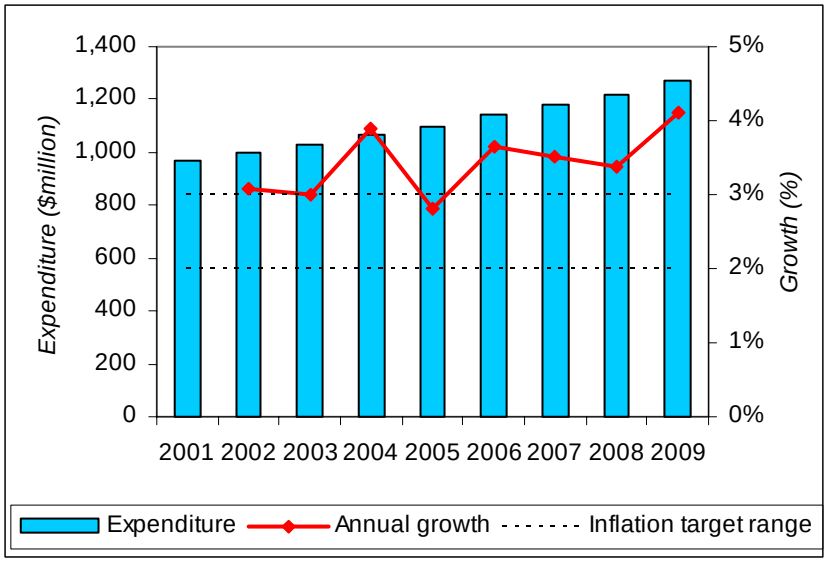
Recommendation 6: Abolish the exemption for minor, infrequent and irregular private use of commercial vehicles or strengthen the substantiation requirements (s.8).

Statutory formula

The current Statutory Formula method (Section 9 of the Act) provides increasingly concessional treatment for longer distances travelled in any one year without any requirement to substantiate a commercial basis for the travel. On top of excessive vehicle use during the year, it is also common for employees to undertake additional journeys near the end of the FBT year (31 March) simply to increase the kilometres travelled and attract a lower statutory fraction for FBT purposes. This widely-recognised "March Corporate Rally" adds to national oil consumption, greenhouse emissions and road congestion and increases motor vehicle costs for business. Evidence from the accounting profession indicates that this concession is being applied well beyond the spirit of the legislation, and that a large proportion of the kilometres being counted under the formula are of a private or domestic nature.

According to the *Tax Expenditures Statement 2005*, the application of the statutory formula to car benefits amounts to a tax payer funded subsidy to corporate car users in excess of $1 billion per annum, or well in excess of the cost of building heavy rail lines to Doncaster East and Rowville in Melbourne each year. Furthermore, this perverse subsidy is growing in the region of 3 to 4 per cent per annum, or greater than the rate of inflation (see Figure 5).

Figure 5: Tax expenditure on statutory formula to value car benefits



Source: Tax Expenditures Statement 2005

Although one option would be to abolish the Statutory Formula completely, in the interests of minimising compliance costs for business we propose that it not be completely eliminated but that it be replaced with an assumption of 5,000 kilometres business use out of the total kilometres travelled in any one year. The statutory fraction would thus be calculated as follows:

$$\frac{A - B}{2 \times A}$$

where -

A is the annualised number of whole kilometres; and
B is the lesser of 5,000 and the annualised number of whole kilometres.

The statutory fraction would then be applied against the base value of the vehicle as per the current operation of the Act. A new Statutory Formula along these lines would have two beneficial effects:

1. an incentive to minimise, rather than maximise, total kilometres travelled in each year thus reducing oil consumption, congestion, pollution and greenhouse emissions and business motor vehicle expenses; and
2. a degree of consistency with the cents per kilometre method applicable to individuals' car expenses under Subdivision 28-C of the *Income Tax Assessment Act 1997* (ITAA).

Where employers and/or employees feel that a revised Statutory Formula calculation does not provide the optimal outcome for their circumstances, the current operating cost methodology (s.10 of the Act) should continue to be available.

Recommendation 7: Replace current statutory fraction calculation with 5,000km business use assumption (s.9)

Car parking fringe benefits

The provision of car parking to employees provides an incentive to drive to work rather than utilise substitutes such as public transport, cycling and walking that cause less pollution and congestion and require little or no parking space. Employer-provided parking often enables employees to avoid a significant after-tax expense that would fail the deductibility tests of Division 8 of the ITAA.

In many cases, particularly in inner urban areas, the provision of car parking benefits represents a substantial commitment of high value land by employers to employees. Where on-premises parking is exempted from FBT, it reduces the incentive to reallocate the land to higher value activities which could deliver greater economic benefit to the firm and the economy more broadly[9].

Since the concessional treatment of car parking acts as a distortion in favour of private car use at the expense of alternative modes of transport, we propose that the 'on-premises' parking exemption be repealed and the car parking benefit provisions be revised. The amended provisions should be mode-neutral by offering exemptions to public transport to at least the same level they are offered to car use.

We suggest that reforms could incorporate initiatives such as:

1. tax-free cash allowances where the employee agrees not to drive to their place of employment (“parking cash-out”);

[9] The many negative side-effects of free parking are discussed in greater length in *High Cost of Free Parking* by Donald C. Shoup (2005)

2. FBT-exempt payment of public transport fares; or
3. travel reimbursement allowances for business trips undertaken by public transport or cycling, rather than just reimbursing car travel.[10]

Such an amendment would encourage the take up of travel modes that are less polluting, require less peak hour road space and that do not require employers to devote such large amounts of land to unproductive use.

Recommendation 8: Replace 'on-premises' concession for employee car parking with concessional allowance applying to all modes of employee transport (s.58GA).

Recommendation 9: Public transport benefits provided to employees should be exempted up to at least the level of the car parking threshold provided for in s.39A(2).

Transport fringe benefits

Taxi travel

Section 58Z exempts certain taxi travel undertaken by an employee from FBT. This provision should be made mode-neutral and apply also to public transport where the journey is made under the same circumstances to which it can be applied to taxi travel.

Recommendation 10: Broaden the taxi travel exemption to include comparable travel by public transport (s.58Z).

Conclusion

The removal of various tax concessions that encourage additional motor vehicle use could simplify tax legislation and allow better targeted tax cuts or rebates. We note that comparable reforms of vehicle taxation in the United Kingdom are estimated to have saved businesses many millions of pounds in recurrent costs as well as contributed to improved efficiency and reduced emissions in the British car fleet. We would be happy to provide further information or discuss how reforms such as these could assist the government to achieve other policy objectives such as greenhouse, road safety and lowering emissions from urban traffic.

[10] http://www.vtpi.org/tdm/tdm8.htm

Appendix A – the Road Deficit

The road deficit in Australia

Costs	**($ million)**	
Road construction & maintenance	8,500	
Land use cost	6,000	
Road trauma	15,000	
Noise	700	
Urban air pollution	4,300	
Climate change	2,200	
Tax concessions	4,200	
Queensland fuel subsidy	500	**41,400**
Revenue		
Fuel excise	9,800	
Registration fees	3,300	
Insurance premiums	10,000	
Tolls	1,000	
Other revenue	2,150	**26,250**
Road deficit		**15,150**

Source: http://www.ptua.org.au/myths/petroltax.shtml