

The Community Tax Forum - Symposium - 16 & 20 May 2009

Car and car-related fringe benefit taxation (FBT) provisions relating to Transport, Housing, Environment, Families, Corporations and Not-for-Profit institutions

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

Architecture of Australia’s tax and transfer system, page 25

...the highly generous tax treatment of motor vehicles, which currently costs over 1\$1billion. This provides unfair advantages to employees who are in a position to obtain the benefit and deprives the government of substantial revenue. It also artificially encourages use of motor vehicles, aggravates traffic congestion and discourages use of public transport. Professor Disney (2007) Personal Income Tax Reform Symposium page 16, para 4.

http://www.atax.unsw.edu.au/research/pitr-symposium-07/papers/Paper_06-Disney.pdf

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Summary

For this Symposium, I understand that the car FBT provision has particular resonance because

- traditionally, the community sector remunerates employees in larger part through fringe benefits rather than cash (or cash-out) payment
- its existence causes adverse environmental effects not only in excessive fuel consumption and emissions and runs counter to the principle of integrating environmental costs and pricing.

The original policy goals for the car FBT provisions are being overtaken. The Henry Review Consultation Paper Summary states that environmental sustainability is of such importance to Australia's future that the Review Panel regards it as a principle against which the current system and potential reforms ought to be tested (pp.11-12). The Review Panel also requires a system that meets revenue needs and has robust administrative and legal frameworks.

I welcome the Symposium in opening up discussion on reform options to the car FBT provisions, including car parking, that:

- remove the incentives to car use, including car parking
- consider whether incentives to use more sustainable transport (public transport, cycling) are desirable to introduce into the personal taxation system, the payroll system or targeted subsidies for improvements to services (on- and off-site) or some combination of these mechanisms, and
- identify ways of remunerating the NFP sector other than through concessional tax treatment of fringe benefits.

Purpose and problems

The current tax provisions for cars and car-related fringe benefits are problems in being:

- a) no longer aligned with their original policy purpose
- b) an Commonwealth economic policy instrument relating to transport that is inconsistent with policy objectives, including social¹ and greenhouse objectives² whether they be government or corporate objectives
- c) contrary to the principles of ESD, particularly for improved valuation, pricing and incentive mechanisms by inclusion of environmental factors (internalisation of external costs)³
- d) cost: 'tax revenue leakage' at \$1.7 billion for 2007, and estimated at \$1.83 billion 2008-09 and rising
- e) an inhibitor to employers/corporations offering effective 'workplace travel programs'
- f) counter-productive to the objectives of State legislative guidelines⁴ to reduce reliance on car travel, particularly during peak hours⁵
- g) contrary to the directions for environmentally sustainable transport adopted in other countries, and contrary to recommendations by the OECD.

No review of the tax treatment of cars and car-related benefits has been undertaken - despite the recommendation from Commonwealth parliamentary inquiries and the observation in 2008 by the National Transport Commission's that 'some taxes and subsidies create incentives that increase car use.' It would be timely for the Henry Review to issue a paper on this topic.

¹ Effective tax rates for the car FBT concession allow major savings for people on the top income tax rate but little or none for those on 15% or 30% (Disney 2007). In practice, employers exercise discretion and do not offer the car FBT to lower-income employees partly because on-site parking space is constrained.

² National Greenhouse Strategy Measure 5.1 and subsequent examination, see Senate (2000), para 6.41. See also Senate Inquiry 2009 terms of reference and submissions.

³ *Protection of the Environment Administration Act 1991* (NSW), s6(2)(d); also

⁴ e.g. Service Planning Guidelines, Sydney Bus Contract Areas, *Passenger Transport Act* (NSW)

⁵ Company and government cars account for 40% of peak hour traffic but comprise 16.5% of car sales in Australia (UITP Submission to Senate Inquiry 2009).

The Henry Review refers to the car Fringe Benefit Tax in several places⁶ in its Consultation Paper (December 2008).

I believe the central provisions to be:

- Fringe Benefits Taxation of cars and car-related benefits (the ‘car FBT’)
- The car parking provisions - exemptions for NFP public education, charitable, scientific and religious institutions (s58G) and small businesses (s58GA)⁷.

Of these provisions, car FBT provision has attracted most attention. Cars are the largest single fringe benefit (LaTrobe-RMIT submission round 1 by Kraal & others).

The FBT provisions are complex and descriptions of its operation are helpful⁸. In essence, there are two features:

1. the method for assessing the taxable value of the car FBT provision contains a multiplier (the statutory fraction rate) according to ‘distance driven’. The rate is regressive, that is the rate declines as the distance driven increases.
2. the value calculated by the statutory formula is then taxed at a concessionary rate, that is below the marginal income tax rate for high income employees.

That these features are now widely regarded as ‘distortions’ indicates how much policy thinking has shifted since the FBT provisions were instituted in 1986, the zenith of car-centred growth and aspiration. The common view and evidence is now:

- The **regressive rate** encourages unnecessary distance to be driven merely to lower the valuation to be taxed;
- The **concessional treatment** is a significant incentive for employees on higher income to purchase and use a car rather than other forms of transport (walk, cycle, public transport or even car sharing (distinct from car pooling)). Consequently, car ownership in the employees household is likely to rise with a corresponding increase in car use even for very short trips that could be done as quickly by walking or cycling; and
- The **valuation** of benefits, particularly car parking, is under-valued.

⁶ Section 4 Personal Tax and Transfers (pp. 87 and ff), and sections 7,11,12 and 13.

⁷ *Fringe Benefits Tax Assessment Act 1986* (Cth)(‘the Act’), Part III Division 2 Car FBT and Division 10A car parking

⁸ Submission to the Henry Review (round 1), Kraal, Yapa and Harvey; Plus an early High Court case, an extract:

*....the taxable value is based on the operating cost of the car, which is the sum of all relevant expenses and includes, in a case where the car is owned by the provider, the amount of depreciation that is deemed to have been incurred by the provider in respect of the car in respect of the year of tax and the amount of interest that is deemed to have been incurred by the provider in respect of the car in respect of the year of tax.*⁸

Queensland v Commonwealth (1987) 162 CLR 74 Gibb CJ at para 5.

Reform options

The issue of the carFBT provision exemplifies a discrete issue but one that needs addressing in the context of a broader picture, as argued by Anglicare, otherwise reforms are likely to be piecemeal.

Nonetheless, once principles are clear and a reform agenda charted, the reforms can be made progressively. For example, the National Transport Commission (2008) anticipated a three year period in which to remove, at least the regressive rate, from the car FBT concession.

The perverse incentives: the regressive rate and concessional tax treatment

Discussions on reform options often conflate these distortions. Reducing these distortions - by flattening the rate for distance driven and removing the concessional tax rate - has long been raised as a reform option, even the option to invest the savings in tax revenue to public transport, and related infrastructure. With the new empirical research by Diane Kraal and colleagues, the LaTrobe-RMIT submission, reform of the regressive rate should be unassailable.

In March 2009 the ACF proposed replacing the 'statutory fraction rate' for distance driven by a rate according to the efficiency of the company car based on the Green Vehicle Guide. By replacing the perverse incentive with an incentive for greener cars, reductions of 20% in greenhouse gas emissions from company fleets may be possible. It is noted that some States already apply an environmental performance score to purchases, and such benefits could be extended to private company cars and possibly cars bought on novated leases.

Option to cap work-related car expenses

Professor Disney in 2007 raised a further option:

"A cap could also be placed on the amount claimable for work-related vehicle expenses, at least unless rigorously substantiated." (page 17, para 10)

A cap may be more effective if it were subject to the marginal tax rate and a cash-out option was mandatory.

Option to introduce a FBT concession for bicycles and public transport tickets

A significant number of submissions, noted in the Consultation Paper proposed the introduction of FBT concessions allowing employers to pay for public transport tickets (as distinct from a loan through salary deduction) and bicycles and bicycle-related benefits. The motivation appears to achieve some formal equality/neutrality between the modes of travel were the car FBT concession to remain e.g. Australian Bicycle Council. However, it would have a very different result financially.

The task of calculating "benefits values" may be a further imposition on employers, or the responsibility transferred to the employee - neither in line with simplifying the tax transfer system. However, the US American Recovery and Reinvestment Act (ARRA) contains further incentives, commenced in February 2009, to use public transport in that it has raised the amount up to US\$230 per month on a par with the car parking benefit (that can or could be cashed-out?).

This option risks entrenching the pre-eminence of car ownership and its prestige within workplaces and would largely fail in responding to the problems (a) to (g) listed above.

Option to exempt public transport tickets and bicycles

ACF has recommended that active transport (public transport, cycling and walking) be exempt from fringe benefits tax (Recommendation 5.4 Submission round 1).

The spatial coverage of public transport networks would mean that this benefit could not be offered by some employers.

Option to eliminate FBT concessions for car parking and remove exemptions

ACF has recommended that fringe benefits tax concessions for parking benefits be eliminated (except where justified on equity grounds, such as for certain disabled workers) (Recommendation 5.4 Submission round 1).

I would also repeal the existing exemption from FBT payable for car parking fringe benefits provided by many NFP institutions across many sectors and by small business. An alternative, adopted earlier in the USA, could be to require the cashing out of this benefit, at market rates.

Option for non-tax policy to improve public transport and cycling facilities

The Australian Bicycle Council also considered that there is scope to use tax system to promote and encourage the adoption of more sustainable transport options including cycling. Reading the Consultation Paper, however, it seems that the personal tax system may be inefficient for the Commonwealth to use as an economic mechanism to displace car travel by more healthy, environmentally sustainable travel. In Australia, the factors inhibiting the use of public transport and cycling to work are generally not thought to be personal cost but due more to services, capacity, safe cycling routes and end-of-trip facilities.

Therefore, Pedal Power ACT has argued for a corporate tax break for companies which provide cycle friendly workplace facilities, as well as removing the FTB concession for car usage and introducing an FBT concession for bicycle and public transport use.

Some people have submitted that fiscal policy be used instead to improve public transport and cycling conditions, in the community and at workplaces, rather than increase tax expenditures on personal benefits for cycling and public transport - particularly because the amounts would be relatively small.

Caution

If the Commonwealth Government decides to retain the car FBT concession, then there appears nowhere else to go on personal taxation policy other than to argue for at least equivalent taxation concessions for public transport tickets, bicycles and bicycle-related costs. This would increase tax revenue leakage; it would not effectively remove the distortions to either transport system or deal with the dominance of cars at the workplace. This (very) second-best argument is made widely to the Henry Review (round 2) and the Senate Inquiry (2009), e.g. by community groups (BicycleNSW, BikeSydney, Pedal Power ACT) and industry (Australasian Railways Association, Bus Industry Confederation, UITP/International Association of Public Transport (Australia & New Zealand)).

Summing up

A great opportunity lies before the Treasury Review of Australia's Future Tax System (the 'Henry Review') to reform the car FBT provision - as its original purpose is being met through the 2008 Car Plan and bail-outs. Yet the car FBT provision has become entrenched creating a challenge to reform options and learning from international experience.

Since cars are projected to remain responsible for about half of transport-greenhouse gas emissions, economic mechanisms must be used to deter car use while investing in more environmentally sustainable transport. Phasing-out the car FBT provisions, by whatever means, is critical.

The car FBT provisions inhibit the use of public transport, cycling, walking and even car sharing (distinct from car pooling), plus have adverse impacts.

A point often overlooked is how the car FBT provision seriously inhibits employers from running workplace travel programs for staff, customers and visitors (Black 1999, Senate 2000) - that would reduce the source of "scope 3" greenhouse emissions. The car FBT provision also inhibits the sensibility of senior corporate staff, in governing and educative institutions such as local councils, the tertiary education sector, and health services - leaving Australia to lag behind other countries where workplace travel programs are widespread.

Is there a rationale for continuing concessional tax treatment of cars and car-related fringe benefits? Or, as PWS prefers, can it not be abolished, requiring employees to pay the marginal tax rate? Could the range car benefits be curtailed?

How are other jurisdictions dealing with remuneration and personal taxation and fiscal policy for managing this issue of maintaining urban mobility while reducing reliance on cars?

Invitation to comment

I welcome your thoughts on how to advance the issues.

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Henry Review Submissions -

Round 1: ACF, ACTU, LaTrobe-RMIT(Kraal et al), National Preventative Health Taskforce, Anglicare, Australian Bicycle Council, ALGA (no mention), Metropolitan Transport Forum [Melbourne], NTC (ambiguous), PriceWaterhouseCoopers, YWCA

<http://taxreview.treasury.gov.au/content/submission.aspx?round=1>

Round 2: ACF, Australasian Railways Association, BicycleNSW, BikeSydney, PedalPower ACT, Chloe Mason(unpublished, available on request)

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