

The luxury car tax: past its use-by date

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Abstract: There are increasing calls to abolish the luxury car tax (LCT) as it has passed its “use-by” date. The tax has been singled out as an unfair, a discriminatory and an inequitable tax that discourages innovation in the manufacture of environmentally friendly vehicles. Following the recommendations from the Henry Tax Review and the discussions at the 2011 Tax Forum on environmental and social taxes, the reform of the LCT could form part of a wider review of motor vehicle taxes and fuel excise in Australia. A tax on the purchase of motor vehicles could be structured to bring about a behavioural change in the choice of motor vehicles in order to reduce fuel consumption in motor vehicles, provide a competitive edge to the Australian motor vehicle industry, and generate the revenues required to build better public transport infrastructure.

Introduction

This article explains why the luxury car tax (LCT), first introduced in Australia on 1 July 2000, has now passed its “use-by” date. This is evident after examining the history of the LCT and the problems and concerns associated with it. The article also explores whether the LCT should be replaced by a motor vehicle purchase tax based on environmental tax principles that could influence Australian motorists’ motor vehicle purchase choices. Alternatively, the revamping of the LCT could form part of a broader reform of all motor vehicle taxes in Australia so that social, economic and environmental costs are efficiently addressed.

History of the LCT

The history of taxing expensive or luxury cars through the LCT dates back to the wholesale sales tax (WST) that was introduced in Australia in 1930 to overcome financial depression and reduce customs revenue. The WST was introduced as a single rate tax, but was amended in 1940 and the early 1970s to become a multi-rate tax with a range of exemptions. Prior to 1993, luxury motor vehicles whose wholesale value was in excess of the luxury motor vehicle threshold were subject to sales tax at a rate of 30%, compared with non-luxury motor vehicles that were taxed at either 15% or 20% depending on the classification of the motor vehicle. This meant that, if the wholesale value of a motor vehicle exceeded the luxury threshold even by one dollar, the increased rate applied to the whole sub-luxury

component of the wholesale value. The Sales Tax Assessment Amendment (Deficit Reduction) Bill 1993 introduced a split rate system for luxury motor vehicles whereby the portion of the wholesale value of a motor vehicle that did not exceed the luxury threshold was taxed at the general rate of 16% or 21%, while the portion that exceeded the luxury threshold was taxed at the 45% rate. The 45% rate was brought in by introducing a new Sch 6 into the *Sales Tax (Exemptions and Classifications) Act 1992* (Cth) (STA92). By the 1996-97 financial year, the WST rates were reflected in eight schedules, ranging from goods classified as basic necessities, such as food, that were exempt from WST in Sch 1 STA92, to passenger motor vehicles which were either taxed at a general rate of 22% in Sch 4 or at the higher rate of 45% in Sch 6 if the value of the motor vehicle was above the luxury motor vehicle threshold.

The luxury motor vehicle threshold for WST purposes was linked to the motor vehicle depreciation limit for income tax purposes. It was specified in Sch 6 STA92 as being 67.1% of the motor vehicle depreciation limit.¹ For the financial year 1998-99, the motor vehicle depreciation cost price limit was \$55,134, and therefore the luxury motor vehicle threshold for the financial year 1998-99 was \$36,995.

The purpose of taxing luxury cars whose taxable value exceeded the income tax depreciation limit for motor vehicles at the 45% rate can be gleaned from the Automotive Industry Commission report where it was viewed as a de facto form

of extra protection for local motor vehicle manufacturers. The report states that vehicle importers were critical of the higher rate of sales tax on luxury passenger motor vehicles as it discriminated against imported cars, since, in reality, the threshold exempted all except a handful of Australian-manufactured cars. The sales tax on luxury motor vehicles was the only instance for which the tax rate varied with the value of the product.²

In examining the Howard government’s 1998 tax reform plan to introduce a broad-based goods and services tax (GST) at the rate of 10% to replace the WST, it is important to bear in mind how and why luxury motor vehicles were taxed under the WST in Australia. Replacing the WST with a 10% GST meant that motor cars would be taxed at the rate of 10% instead of 22% and 45%. The government did not believe that it was appropriate for the price of luxury cars to fall as a result of the change from WST to GST, and therefore, in addition to introducing the GST, the tax reform plan also proposed to introduce the LCT. As a result, the LCT was first introduced in Australia on 1 July 2000 along with the GST, and the WST was abolished. The A New Tax System (Luxury Car Tax) Bill 1999 (Cth) imposed the LCT at a rate of 25% on the value of motor vehicles above a specified threshold. The threshold set was the motor vehicle depreciation limit for the 1998-99 financial year, which was \$55,134.³ The explanatory memorandum to the Bill stated that the main policy objective for introducing the LCT was to ensure that the price of luxury cars fell by about the same

amount as a non-luxury car when GST came into operation.⁴

In 2008, the LCT was amended in the A New Tax System (Luxury Car Tax) Amendment Bill 2008 (Cth) (ANTS (LCT) 2008 Bill) and related Bills to increase the LCT rate from 25% to 33%. There was considerable opposition from the other political parties and motor vehicle industry groups, and this was reflected in a Senate Committee Inquiry into the ANTS (LCT) 2008 Bill. After considerable debate in parliament, the Greens Senator at the time, Christine Milne, succeeded in achieving a higher threshold of \$75,000 for fuel-efficient luxury cars that consumed less than seven litres of fuel per 100 kilometres, instead of the normal \$57,180 threshold. The current LCT thresholds for the 2012-13 financial year are \$59,133 for normal cars and \$75,375 for fuel-efficient cars.

The next section explores the problems with and concerns about the LCT and why it should be either abolished or reformed to meet specific environmental goals.

Problems with and concerns about the LCT

A number of issues with the LCT have been noted, as discussed below.

Only serves a historical purpose

As discussed previously, the LCT only serves a historical purpose and it is the only tax in Australia that is imposed on luxury goods. Other luxury goods taxed at higher rates under the WST have not been taxed again, other than under the GST legislation. The Senate Committee Inquiry into the ANTS (LCT) 2008 Bill summed up the rationale for taxing luxury cars at a higher rate than other goods and services as follows:⁵

“The original 1986 wholesale sales tax appears to have been a protectionist measure, designed to increase the price of European imports, while the 2000 LCT was introduced to ensure the introduction of GST did not result in a sudden reduction in the price of luxury vehicles, apparently because this might erode support for GST.”

As a result of the 2008 amendments, the original protectionist purpose of the LCT also appears to have been lost as it no longer acts as a tariff on a large number of imported cars. For example, the new Mercedes-Benz S Class range has a new diesel model that uses less than 7 litres per 100 kilometres and therefore escapes the LCT.⁶ The most popular luxury car is the Toyota LandCruiser, and

the LCT is increasingly attracted by people-movers and family four-wheel drives such as the Nissan Patrol or the Mitsubishi Pajero and the top-end Ford and Holden models.⁷ Submissions made to the Senate Committee Inquiry into the ANTS (LCT) 2008 Bill have highlighted that the number of four-wheel drives and SUVs attracting LCT has risen from less than 100 vehicles in 1979 to 38,000 in 2007.⁸

Lower direct tariff does not give reciprocal access to overseas car market

As stated above, the initial purpose of introducing higher tax rates on luxury cars was to act as a tariff on imported cars. The European Union and some other importers have criticised the LCT as a disguised form of protection for the Australian car industry.⁹ The demand for European and other imported cars has in fact increased in Australia as a result of the high Australian dollar and European cars satisfying the higher threshold for being fuel efficient.

Not only does the LCT fail to protect the Australian car industry, but a lower direct tariff rate in Australia no longer allows Australian car manufacturers equal access to overseas markets. Other countries have far higher direct tariff rates compared with the Australian average vehicle tariff of 3.5%. In fact, Australia has one of the lowest direct tariffs on imported cars compared with other countries, for example: the EU and the United Kingdom: 10%; China: 25%; India: 60%; Thailand: 80%; Malaysia: 30%, plus 105% excise on larger cars and a 75% impost on smaller cars; Russia: 30%, plus an additional 18% VAT; and Brazil: 35%, plus an additional industrial products tax. In addition, other countries have other non-tariff barriers that make it difficult to export to these markets.¹⁰ Thus, the original intention for the LCT to act as a tariff against other nations needs to be re-examined and replaced by a new way of thinking about motor vehicles taxation.

It is discriminatory, inequitable and does not serve fairness

The question to ask is why vehicles should be singled out as luxury items and have further tax imposed on them. The Victorian Automobile Chamber of Commerce challenges the notion that cars should be taxed as a luxury, pointing out in its submission to the Senate Select Committee Inquiry on LCT that:¹¹

“Other high-priced consumer goods are not taxed as luxuries, holidays, expensive homes, expensive restaurant meals, holiday homes, yachts are not taxed as luxuries. Other imported goods such as furniture, artworks, plasma televisions, jewellery, watches and antiques are similarly not taxed as luxuries. Yet vehicles are taxed as luxuries.”

The senior executive director of Toyota Australia condemns the LCT for being discriminatory and calls for either its abolition or fundamental reform.¹² The imposition of the LCT could only be justified on the grounds that it is relatively easy to collect and is equitable from the point of view that it taxes those most able to afford it.¹³ From the equity perspective, the Henry Tax Review classified the LCT as inequitable due to a breach of the principle of horizontal equity, in that people with the same economic means will pay different amounts of tax depending on their tastes. The Henry Review also reported that the LCT is flawed in its impact on vertical equity as some people of average means may prefer cars that are expensive due to their size, for example, a seven-seater minivan which may be of the same price and attract the same LCT as a small sports car.¹⁴

A similar sentiment was voiced by *Top Gear Australia* that the real-world Australians who buy good cars are not automatically the “undeserving rich”.¹⁵ Moreover, the redistribution of wealth should be managed through the broader tax-transfer system and not through differential taxes on specific categories of goods preferred by low-income or high-income households.¹⁶ At the Senate Select Committee Inquiry on LCT, the Federal Chamber of Automotive Industries revealed that almost 70% of cars that were subject to LCT were not cars of “millionaires”, as they were sold for less than \$75,000.¹⁷

It leads to evasion or avoidance

The *Australian Financial Review* has recently reported that a loophole in the LCT legislation allowing an exemption from the LCT if a motor vehicle is purchased as trading stock is being abused by buyers quoting an Australian business number to the dealer. The cars are then used for personal purposes and sold off after two years of ownership when owners are no longer liable to pay the LCT. The then Chief Executive of the Federal Chamber of Automotive Industries, Andrew McKeller, has been quoted as saying, “the anecdotal evidence coming from the industry is there

is a rising prevalence of abuse and non-compliance in this area”¹⁸

Tax avoidance also occurs as a specific LCT threshold encourages cars to be priced at just below the threshold limit in order to increase sales. Alternatively, buyers forgo optional extras and get the cars fitted with after-market products.¹⁹

It does not encourage innovation

The LCT is based on the price of the vehicle and, to a small extent, the fuel consumption. It excludes all other factors, such as the need for new technologies, innovative new manufacturing techniques, alternative fuel engines, increased safety and lower emissions.²⁰ The motor vehicle industry is currently spending billions of dollars on research and development on environmentally friendly models using alternative power, such as electric, hybrid, LPG, diesel, ethanol and unleaded petrol.²¹ Customer demand for environmentally friendly models has increased the price of cars and, as a result, more cars are now captured within the LCT threshold. In 1979, only 2% of new vehicles were captured within the LCT threshold. However, this percentage rose to 4.5% in 1986 and to 12% in 2007.²² Imposing the LCT based on just the price of the car has the impact of discouraging innovation. It has also been argued at the Senate Select Committee Inquiry on LCT that the LCT represents a tax on safer and more fuel-efficient vehicles.²³ A review should be conducted on new ways of taxing motor vehicles to encourage the purchase of smaller and lighter cars that consume less oil and produce fewer emissions. This is briefly discussed below.

LCT reform and review of motor vehicle taxes and fuel excise in Australia

The Henry Tax Review reported that luxury taxes should not be used to raise revenue as they are inefficient due to their narrow base, and they are also ineffective and arbitrary means of redistributing wealth.²⁴ The Henry Tax Review also made recommendations to the Australian Government to abolish the LCT and to replace vehicle registration taxes with more efficient road user charges, further suggesting that the current fuel excise should be phased out and that transport-specific taxes should only be imposed where they improve social or market outcomes.²⁵ At the 2011 Tax Forum session on environmental and social taxes,

the following opinions were voiced: John Freebairn suggested that user-pay fees for roads should be tied to the kilometres travelled per year, the vehicle weight and the state of the road; Harry Clarke argued for comprehensive congestion pricing in Australia by learning from the experiences in other places such as London, Stockholm and the Netherlands; Ian Chalmers called for the abolition of the LCT or its redesign to encourage reduced CO₂ emissions, and showed a preference for alternative options in terms of road broad-user charges and not just congestion charging; Brendon Lyon called for a reasoned and seasoned debate about how to deal with congestion and the infrastructure backlogs in Australia; and Frank Stilwell favoured the use of taxes to change behaviour.²⁶

There is a clear message to the Australian Government to reform LCT and conduct a review of motor vehicle taxes and fuel excise in Australia. In this respect, lessons can be learnt from other countries, for example, Norway’s unique motor vehicle purchase tax system which imposes tax at progressive rates based on three criteria (vehicle weight, engine capacity, and CO₂ emissions),²⁷ or the unique mileage fee concept tested under the parliament-approved Oregon Road User Fee Pilot Program.²⁸ The author’s PhD thesis, Using tax and regulatory measures to reform choice and usage of motor vehicles for personal transportation in Australia for the sustainability of oil,²⁹ could enhance the debate in this much-needed area of reform.

Conclusion

Calls for the abolition of the LCT are coming from key community bodies and individuals in Australia. The LCT has certainly passed its use-by date and appears to serve no purpose other than inequitable revenue raising for the Australian Government. Such a tax could very well be used for a number of policy objectives, including behavioural change in the choice of motor vehicles in order to conserve oil. It is now time for the Australian Government to ignite a debate on the reform of road transport-related taxes and charges, including the reform or abolition of the LCT.

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