The Senate

Economics Legislation Committee

Reform of the car fringe benefits tax rules: Provisions of Schedule 5 of the Tax Laws Amendment (2011 Measures No. 5) Bill 2011

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Senate Economics Legislation Committee

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TABLE OF CONTENTS

Chapter 1

Schedule 5 of Tax Laws Amendment (2011 Measures No. 5) Bill 2011

Referral of the bill

1.1 Tax Laws Amendment (2011 Measures No. 5) Bill 2011 (the bill) was introduced into the House of Representatives on 2 June 2011. On 15 June 2011, on the recommendation of the Selection of Bills Committee, the Senate referred the provisions of Schedule 5 of the bill to the Economics Legislation Committee (committee) for inquiry and report by 21 June 2011.[1] Schedule 5 of this omnibus bill proposes amendments to the *Fringe Benefits Tax Assessment Act 1986* to reform the car fringe benefits tax (FBT) rules.[2]

Background to Schedule 5

Australia's Future Tax System Review

1.2 In its report to the Treasurer in December 2009, the *Australia's Future Tax System* review (the tax review) noted that:

> ...[i]n some cases, existing tax and transfers settings are inconsistent with broader environmental objectives.[3]

1.3 The tax review went on to cite the current statutory formula for valuing car fringe benefits as an example of an existing tax setting with the potential to create incentives for individuals to travel additional distances, in turn increasing pollution and congestion.[4] In citing this particular example, the tax review recommended:

> 9(b) The current formula for valuing car fringe benefits should be replaced with a single statutory rate of 20 per cent, regardless of the kilometres travelled.[5]

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1 Journals of the Senate No. 32, 15 June 2011, p. 957.

2 Tax Laws Amendment (2011 Measures No. 5) Bill 2011, *Explanatory Memorandum*, p. 123.

3 Department of the Treasury, *Australia's Future Tax System – Report to the Treasurer, Part One Overview*, December 2009, p. 10.

4 *Australia's Future Tax System – Report to the Treasurer, Part One Overview*, December 2009, p. 10.

5 *Australia's Future Tax System – Report to the Treasurer, Part One Overview*, December 2009, p. 82.

The 2011-12 federal budget

1.4 In the 2011-12 federal budget the government announced that it would reform the car fringe benefit rules to implement the recommendation of the tax review.[6] In announcing the reform, the government detailed that the changes would only apply to new vehicle contracts entered into after 7:30pm AEST on 10 May 2011 (budget night) and would be phased in over four years.

1.5 In making this announcement, the government specified that existing contracts would be grandfathered and therefore subject to existing arrangements.[7]

1.6 At the time of its announcement, the measure was identified as having the following effects:

> Compared to the current statutory rates, a single rate of 20 per cent will:
>
> - increase the tax concession provided for vehicles driven less than 15,000 kilometres a year;
> - maintain the current tax concession provided for vehicles driven between 15,000 and 25,000 kilometres a year; and
> - decrease the tax concession provided for vehicles driven more than 25,000 kilometres a year.[8]

1.7 The government also identified that those people who use their vehicle for a significant amount of work-related travel would still be able to use the 'operating cost' (or 'log book') method to ensure their car fringe benefit excludes any business use of the vehicle.[9]

Revenue implications

1.8 The 2011-12 budget detailed that the proposed changes would not only result in an ongoing revenue gain of $970 million over the forward estimates, but would also increase goods and services tax payments to the states (by $50 million), while decreasing government expenditure (by $33.9 million).[10]

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6 Department of the Treasury, *Budget, Budget Measures, Budget Paper No. 2, 2011-12*, 10 May 2011, p. 23.

7 *Explanatory Memorandum*, p. 5.

8 The Hon Wayne Swan MP, Treasurer, and the Hon Bill Shorten MP, Assistant Treasurer, Joint Media Release, Reforms to car fringe benefits rules, No. 50, 10 May 2011, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/050.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 19 June 2011).

9 The Hon Wayne Swan MP, Treasurer, and the Hon Bill Shorten MP, Assistant Treasurer, Joint Media Release, Reforms to car fringe benefits rules, No. 50, 10 May 2011, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/050.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 19 June 2011).

10 Department of the Treasury, *Budget, Budget Measures, Budget Paper No. 2, 2011–12*, 10 May 2011, p. 23.

Scrutiny of bills committee

1.9 The Scrutiny of Bills Committee considered TLAB 5 of 2011 in its *Alert Digest* No. 5 of 2011. The committee noted that it:

> ...has regularly been prepared to accept amendments proposed in the Budget will have some retrospective effect when the legislation is introduced, though this is usually limited to publication of a draft bill within 6 calendar months after the date of that announcement. Given that this measure was announced in the 2011 Budget **the Committee leaves to the Senate as a whole the question of whether this measure should be given retrospective operation as proposed.**[11] [emphasis in original]

1.10 The Scrutiny of Bills Committee made no further comment on the approach taken in Schedule 5 of the bill.

Conduct of the inquiry

1.11 The committee was referred this inquiry on 15 June and asked to report by 21 June. On 15 June, the committee wrote to a number of stakeholders inviting submissions by 20 June. Time did not permit for the advertising of the inquiry in the national press.

1.12 The committee received five submissions; a list of submitters to the inquiry is set out in Appendix 1. (Submitters were generally supportive of the amendments proposed by Schedule 5.) Public hearings were not held due to the limited time for the inquiry.

1.13 The committee thanks those organisations who made submissions to the inquiry and acknowledges the tight timeframes in which these contributions were made.

Structure of the report

1.14 This report is comprised of two chapters. Chapter 2 addresses the issues raised by stakeholders during the inquiry process.

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11 Scrutiny of Bills Committee, *Alert Digest No. 5 of 2011*, p. 51.

Chapter 2

Views on Schedule 5

Overview of schedule 5

Fringe benefits tax

2.2 The fringe benefits tax (FBT) year begins on 1 April and ends on 31 March. FBT is paid by employers and is self assessed. The current rate at which the tax applies is 46.5 per cent.[1]

2.3 A fringe benefit is a non-cash 'payment' to an employee; it is a benefit provided in respect of employment.[2]

2.4 There are a large number of benefits that are caught by the FBT rules. Schedule 5 of the bill relates specifically to car fringe benefits.

Car fringe benefits

2.5 A car fringe benefit arises in situations where an employer makes a car they own or lease available for the private use of an employee. A car is considered to have been 'made available' for private use by an employee where:

- the car is actually used for private purposes;
- the car is not at the business premises and the employee is allowed to use it for private purposes;
- the car is garaged at the employee's place of residence regardless of whether or not they have permission to use it privately.[3]

2.6 In situations where a fringe benefit is provided to an employee, employers are required to pay FBT. Under the existing rules, to calculate the taxable value of a car fringe benefit, an employer can elect to use one of two methods:

(a) the operating cost method; or

(b) the statutory formula method.[4]

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1 Australian Taxation Office, *Calculating fringe benefits tax*, http://www.ato.gov.au/businesses/content.aspx?doc=/content/52006.htm (accessed 19 June 2011).

2 Australian Taxation Office, *What is fringe benefits tax*, http://www.ato.gov.au/businesses/content.aspx?doc=/content/52006.htm (accessed 19 June 2011).

3 Australian Taxation Office, *Car fringe benefits tax*, http://www.ato.gov.au/businesses/content.aspx?doc=/content/52006.htm (accessed 19 June 2011).

2.7 Under the operating cost method, employers are required to maintain a log book, for a specified period, as the taxable value is based on the cost of owning and operating the car, reduced by the proportion that relates to business use.[5]

2.8 The operating cost method for valuing car fringe benefits will not be changed as a result of Schedule 5; it will remain available for employers to use.[6]

2.9 The statutory method on the other hand is designed to provide employers with a low compliance cost alternative to the operating cost method.[7] It does this by basing the taxable value of the benefit on the cost of the car multiplied by the relevant statutory formula. The relevant statutory formula is determined by the number of kilometres the car travels in a year. As a result, as the number of kilometres travelled increases, the value of the fringe benefit, and therefore the tax burden that applies to the benefit, decreases.[8]

2.10 Under the existing rules, the statutory rates are:

Total kms travelled during the year	**Statutory rate**
Less than 15,000	0.26
15,000 to 24,999	0.20
25,000 to 40,000	0.11
Over 40,000	0.07

Source: *Explanatory Memorandum*, p. 125.

Schedule 5 – the details

2.11 The amendments proposed by Schedule 5 of the bill will amend these statutory rates, replacing all four with a single statutory rate of 20 per cent. The explanatory memorandum to the bill explains that:

> [a] flat statutory rate of 0.20 will better reflect the fair value of the private benefit being provided to the employee and places employees with access

4 Australian Taxation Office, *Car fringe benefits tax*, http://www.ato.gov.au/businesses/content.aspx?doc=/content/52006.htm (accessed 19 June 2011).

5 *Explanatory Memorandum*, p. 123.

6 *Explanatory Memorandum*, p. 125.

7 *Explanatory Memorandum*, p. 124.

8 *Explanatory Memorandum*, p. 124.

to fringe benefits on a more even footing with employees whose remuneration consists entirely of salary or wages.[9]

2.12 The change proposed by Schedule 5 will be phased in for new contracts over four years as follows:

Table 1: Timeframe for transition to the new statutory rate

Distance travelled during the FBT year (1 April – 31 March)	**Statutory rate (multiplied by the cost of the car to determine a person's car fringe benefit)**				
	Existing contracts	**New contracts entered into after 7:30pm (AEST) on 10 May 2011**			
		From 10 May 2011	**From 1 April 2012**	**From 1 April 2013**	**From 1 April 2014**
0 – 15,000 km	0.26	**0.20**	0.20	0.20	0.20
15,000 – 25,000 km	0.20	**0.20**	0.20	0.20	0.20
25,000 – 40,000 km	0.11	**0.14**	**0.17**	**0.20**	0.20
More than 40,000 km	0.07	**0.10**	**0.13**	**0.17**	**0.20**

Source: The Hon Wayne Swan MP, Treasurer, and the Hon Bill Shorten MP, Assistant Treasurer, Joint Media Release, Reforms to car fringe benefits rules, No. 50, 10 May 2011, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/050.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 19 June 2011).

2.13 An employer may elect to skip the transitional arrangements and apply the new statutory rate of 0.20 immediately; this 'opt-in' however, cannot be accessed without the consent of the affected employee.[10]

Transitional arrangements

2.14 Contracts existing before budget night 2011-12 will not be affected by the changes; the existing statutory rates will continue to apply. For an existing contract to apply at that time (budget night 2011-12) requires that a financially binding commitment had been entered into by one or more of the parties.[11]

9 *Explanatory Memorandum*, p. 125.

10 *Explanatory Memorandum*, p. 134.

11 *Explanatory Memorandum*, p. 130.

2.15 Changes made after budget night 2011-12 to contracts entered into before that time, will however be considered to be new commitments and therefore subject to the new arrangements.[12]

Consequential amendments

2.16 Schedule 5 of the bill also contains some minor consequential amendments to update the provisions and ensure that the provisions that will not be required following the completion of existing contracts, grandfathered as a result of the Schedule 5 amendments, are repealed at that later point in time (1 April 2016).[13]

Issues raised

General support for reform

2.17 Submitters to the inquiry were supportive of reform and acknowledged the need for changes to the existing FBT rules for motor vehicles:

> The Tax Institute broadly supports the Government's implementation via Schedule 5 of the Bill of Recommendation 9(b) of the Henry Tax Review (also known as Australia's Future Tax System Review) that "[t]he current formula for valuing car fringe benefits should be replaced with a single statutory rate of 20 per cent, regardless of the kilometres travelled".
>
> As The Tax Institute has publically expressed, this measure represents a sensible reform that removes any incentives that may exist for people to drive further for the sole purpose of lowering the fringe benefits tax (FBT) liability resulting from the associated car fringe benefit. The replacement of a sliding scale with a flat statutory rate is also welcomed as a step towards a simpler FBT system.
>
> Once the transitional arrangements contained in Schedule 5 of the Bill cease to apply, the flat statutory rate will result in simpler FBT laws and therefore a lower compliance burden for employers that provide car fringe benefits.[14]
>
> The industry acknowledges that the existing approach, using a kilometre-based threshold, is out of date and is inconsistent with the goal of reducing carbon emissions from motor vehicles.[15]
>
> [The] MTAA agrees the existing rules connected with fringe benefits tax (FBT), as it relates to motor vehicles, would benefit from simplification and will always support good policy and mechanisms that seek to reduce regulatory and other compliance burdens upon small businesses. In that

12 *Explanatory Memorandum*, p. 127.

13 Tax Laws Amendment (2011 Measures No. 5) Bill 2011, lines 3 to 9, p. 65.

14 The Tax Institute, *Submission 3*, pp 1–2.

15 Federal Chamber of Automotive Industries (FCAI), *Submission* 2, p. 1.

> context, MTAA offers its in-principle support to the reforms outlined by the Bill.[16]

2.18 In supporting the reforms, submitters did suggest however that broader reforms to motor vehicle taxation, particularly luxury car taxation, should also be considered.[17]

Possible unintended consequences

2.19 In noting their support for reform of the existing car fringe benefits arrangements, stakeholders raised concerns that the application of the changes may have unintentional consequences for motorists in rural, regional and outer-metropolitan areas.[18] When commenting on the budget measure, the FCAI stated:

> Industry will be concerned to ensure that those people who legitimately need to use their vehicle for business purposes are not faced with an unnecessary tax hike as a consequence of this measure... Just because you live a bit further from the city, or in a country town and need to cover longer distances, doesn't mean you should pay more tax on the car you drive.[19]

2.20 The FCAI urged the committee to consider an alternative statutory rate of 15 per cent so as to minimise the impact of the change on motorists whilst still removing the distortions of the current regime:

> Additional analysis contained in a Treasury costing report...shows that of the 570,000 fringe benefit vehicles, 60.4% (344,280 motorists) will be adversely affected by this change. As rural, regional and outer-metropolitan motorists are more reliance on their motor vehicles for daily work purposes, they are also likely to incur a higher burden from this tax increase... Amending ...[Schedule 5 of the bill]... to a flat rate of 15 % would, as discussed in the Henry Tax Review, remove the current distortion to increase vehicle use and result in a more modest increase in taxation revenue.[20]

2.21 The MTAA were also of the view that the reforms may have unintended consequences:

> However MTAA believes there will be potentially unrealised and consequential impacts as a result of the operation of the proposed Bill. MTAA has previously observed motor vehicle market distortions fuelled by changed consumer behaviours. This has, on occasion, resulted from delays in implementing new or changed policy, regulations and / or legislation.

16 Motor Trades Association of Australia (MTAA), *Submission 1*, p. 1.

17 FCAI, *Submission 2*, p. 1; MTAA, *Submission 1*, p. 1.

18 FCAI, *Submission 2*, p. 1; MTAA, *Submission 1*, p. 1.

19 FCAI, FBT on Motor Vehicles, Media Release, 10 May 2011, p. 1.

20 FCAI, *Submission 2*, p. 1.

> Examples include:
>
> - motor vehicle purchase or replacement decisions have accelerated or been delayed creating market uncertainty- particularly for new car dealers;
>
> - the impact of changes on consumer driving habits, particularly in regional and rural Australia where businesses are required to travel long distances.[21]

Unrelated matters

2.22 The committee notes that the Tax Institute has raised a number of concerns that are not within the scope of its inquiry. The committee has referred these issues to the Minister for consideration.

Committee comment

2.23 The committee acknowledges the concerns of the automotive industry however considers that the government's decision to introduce the changes to the statutory rate over a four year period will ensure that affected taxpayers have the time and opportunity to make the necessary arrangements to transition to the new regime.

2.24 The committee concurs with the Tax Institute that additional examples should be included in the explanatory material.[22]

Recommendation 1

2.25 The committee recommends that the Senate pass the bill. The explanatory material should be updated to address the issues raised by the Tax Institute.

Senator Annette Hurley
Chair

21 MTAA, *Submission 1*, p. 1.

22 The Tax Institute, *Submission 3*, pp 2-3.

Additional Comments from Coalition Senators

Car fringe benefits tax rule changes

The proposed changes

1.1 Schedule 5 of the *Tax Laws Amendment (2011 Measures No.5) Bill 2011* changes the current ‘statutory formula’ method for determining the taxable value of car fringe benefits.

1.2 It replaces the three current statutory rates with a single rate of 20 per cent that applies regardless of the distance travelled.

1.3 The statutory rates that applied prior to these changes were as follows:

Total kilometres travelled during the year	**Statutory percentage**
Less than 15,000	26%
15,000 to 24,999	20%
25,000 to 40,000	11%
Over 40,000	7%

1.4 The changes contained in Schedule 5 were announced in the 2011-12 Budget and apply immediately from 10 May 2011 to all new car leases or car purchases from that date onwards.

1.5 The changes will mean that those who drive less than 15,000 kilometres a year will now pay less FBT and those who drive between 15,000 and 25,000 kms a year will pay the same.

1.6 However those drivers who drive more than 25,000 kms a year will pay more fringe benefits tax.

1.7 The proposed measures will not apply to existing car leases or car purchases entered into before 10 May 2011. For these contracts, FBT will be calculated based on the old statutory fractions that applied prior to that date.

Increase in Government Tax Revenue

1.8 This measure has an ongoing gain to Budget revenue of $961.9 million over the forward estimates. This increased tax revenue will be spread across the forward estimates as follows:

2010-11	2011-12	2012-13	2013-14	2014-15
$5m	$29.4m	$140.4m	$331.2m	$455.9m

1.9 This measure is also expected to increase GST payments to the States by $50 million over this period due to the increase in FBT liabilities under the proposed change. This will occur as the increased FBT will increase State revenues from payroll tax and WorkCover which therefore increases GST Payments to the States.

Increased costs on Employers

1.10 Employers will be affected by the changes. Where an employer previously paid FBT at a statutory fraction of 26% on a car benefit, the reduction to the 20% statutory fraction will reduce the FBT payable.

1.11 However, as above, the FBT on those cars which were previously valued at statutory fractions of 7% or 11% will add to the FBT cost for employers.

Increased taxes for Australians who use motor vehicles for work purposes

1.12 This measure is another tax on those Australians who rely on their motor vehicle to earn their income and have to travel long distances, including tradespeople, salespeople, couriers, primary producers and small business people.

1.13 Official figures show that there are 570,000 cars operating under the existing statutory formula.

1.14 According to evidence given at Senate Estimates of those 570,000 cars around 60% will be worse off, 15% will be better off, and 25% will see no change to their current arrangements.

1.15 These figures highlight that 342,000 Australians will pay more tax because of this latest Labor tax grab.

1.16 The impact of these increased taxes will fall disproportionately on people who live in outer metropolitan, regional and rural areas of Australia who need to drive longer distances than inner city residents.

Comment

1.17 This is another tax grab inflicted on Australian workers by a government that is addicted to higher taxes and higher spending.

1.18 The negative impact of this tax grab will be harshest on people who live and work in outer metropolitan areas as well as regional centres and rural areas. These people will be punished by the Labor government through no fault of their own, as they need to drive longer distances on a regular basis.

1.19 The government will earn nearly $1 billion of extra taxes over the forward estimates as a result of these changes. This tax grab is only needed because the Labor government has mismanaged Australia's finances so badly over the past 4 years resulting in huge budget deficits and net government debt forecasted to peak above $100 billion in 2011-12.

1.20 If the government had not spent outrageous amounts on programs such as the pink batts fiasco, overpriced school halls and failed green loan schemes there would be no need to slug working Australians with extra taxes.

1.21 People in outer metropolitan, regional and rural areas are now being asked to pay for Labor's reckless spending, record Budget deficits and record government debt.

1.22 The Coalition notes that this measure was a recommendation from the Henry Tax Review, and that to date the government's approach towards addressing issues outlined in the Henry Tax Review has been to cherry pick those measures which assist in improving the government's budget bottom line, as opposed to genuine taxation reform.

Recommendation 1

1.23 That the Senate Economics Committee examines the changes made by Schedule 5 within one year of their introduction to assess the actual impact of the changes on:

- **small business in Australia;**
- **motorists in outer metropolitan, regional and rural areas; and**
- **any substitution effect between the statutory method and alternative methods of calculating FBT on motor vehicles, such as the log book method.**

Senator Alan Eggleston
Deputy Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Motor Trades Association of Australia
2	Federal Chamber of Automotive Industries
3	The Tax Institute
4	Australian Equipment Lessors Association
5	GE Capital ANZ