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1 June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
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Dear Sir/Madam

TAX DISCUSSION PAPER – AUTOMOTIVE INDUSTRY COMMENTS

The Federal Chamber of Automotive Industries (FCAI) is the peak industry body for Australia's manufacturers and importers of passenger motor vehicles, four wheel drives, light commercials and motorcycles. The membership of the FCAI is listed on our website at www.fcai.com.au and these members cover the vast majority of the new vehicles sold in Australia each year.

Our members are the authorised distributors and representatives of the particular marque they sell and are responsible for all aspects of the supply chain to the dealerships in Australia. This involves the membership in a raft of interfaces with taxation and regulatory authorities ranging from the Federal Treasury though to local councils. Our submission to the discussion paper will however focus on five key areas of federal and state taxation for our industry including:

- Taxable income
- Luxury Car Tax
- Application of GST to dealer incentives
- Fringe Benefits Tax for motor vehicles
- Customs Tariff

Prior to addressing the particular concerns we would like to draw your attention to the need for a whole of government approach when reviewing tax law policy to improve consistency and also to reduce regulatory burden. Reference is made to a speech by Mr Terry Moran[1], former Secretary Department of Prime Minister and Cabinet concerning the goal for a holistic approach to government policy as follows:

"Strategic policy advice must consider the levers available to government across all policy domains and not restrict itself to particular silos."

[1] Speech by Mr Terry Moran AO Secretary, Department of the Prime Minister and Cabinet to the Institute of Public Administration Australia Public Lecture Reform of Government Administration: From Blueprint to Outcomes 18 May 2010 at page 3.

Further in relation to this holistic approach, the Advisory Group on Reform of Australian Government Administration have recommended that when Government considers changing regulations, care needs to be taken to avoid regulatory burden[2].

1. Taxable income

In view of the above the FCAI recommends that the current wording of Division 815B of the Income Tax Assessment Act be an amended to ensure that any adjustments to "taxable income" under the operative provisions of Division 815B are referrable to a particular underlying transaction. This is required to ensure that any adjustments for income tax will be afforded consistent treatment under the Customs Act for Customs Duty and Declarations purposes. This is a significant issue for FCAI members as the importation of vehicles are subject to valuation rules under both the Income tax Assessment Act and the Customs Act. We believe that it is both inappropriate and unworkable to have two different sets of valuation rules for the same vehicles. A whole of government approach to taxation is necessary.

2. Luxury Car Tax

For the reasons stated in the Henry Tax review, the LCT is an inequitable and anachronistic tax. It drives an enormous degree of angst amongst consumers, dealers and distributors not least for the fact that the indexation arrangements have seen tax creep apply to many vehicles that do not meet the intent of the original design of the tax. As such, the FCAI holds that at a minimum the LCT should undergo a phased transition to full abolition.

The FCAI draws your attention to Appendix A to this paper which presents the history and policy behind the LCT to demonstrate that the tax clearly fails when assessed against the key principles for tax systems: equity, efficiency and simplicity. It also provides a complete analysis of the LCT and supports the FCAI contention that the tax is unfairly focused on purchasers of motor vehicles and should be abolished.

While abolition of LCT is the most appropriate policy response another important additional aspect to be considered in respect of the current application of LCT is the safety aspects of accessories and the application of LCT. Various marques / brands develop accessories to operate as a fully integrated part of a vehicle. In essence, this means that the same performance standards are applied to genuine accessories as applied to the vehicles themselves, including standards relating to safety, durability, corrosion and fire hazard.

The FCAI has a concern that many after-market accessories:

(a) compromise road safety, including passenger safety, by, for example, rendering air bags ineffective or less effective in a crash;

(b) may not comply with the Australian Design Rules, which are intended to maximise road safety through vehicle design; and

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[2] Ahead of the Game Blue Print For the Reform Of Australian Government Administration March 2010 Recommendation 1.4: Reduce unnecessary Business Regulation Burden - advisory Group on Reform of Australian Government Administration

(c) compromise road safety by accelerating vehicle fatigue and decreasing vehicle durability, leading to vehicles that are operating outside acceptable performance parameters sooner than could reasonably be expected by their operators.

The LCT Act provides for the imposition of tax on the sale or importation of a luxury car. Any accessory, including, for example, nudge bars, that are supplied, paid for or arranged at or before the supply of the car would be included in the luxury car tax value. This leads to a different tax treatment for genuine accessories which are supplied with the car or arranged at the time of the supply of the car and after-market accessories that may be supplied immediately after the supply of the car. This leads to a more favourable tax treatment for products that are quite possibly unsafe and, in many cases, unlikely to be compliant with the Australian Design Rules, where those products are intended by the vehicle owner to have the same purpose as the genuine accessory and where the basis for the tax treatment is the immediacy of the supply (in many cases, a matter of hours as new owners drive out of a dealership and immediately source an after-market accessory for their new vehicle).

Marques / brands are aware, through their extensive dealer networks throughout Australia, that many customers are not purchasing genuine accessories, but instead buying aftermarket accessories, because there is no luxury car tax payable on the purchase of aftermarket accessories. Therefore, the unequal luxury car tax treatment of genuine accessories and after-market accessories is causing a significant number of vehicle owners to fit non-genuine after-market accessories to their vehicles instead of genuine accessories. For the reasons set out above, FCAI members and its network of authorised dealers are concerned that the unequal luxury car tax treatment of accessories is a significant road safety issue which encourages vehicle owners to buy and fit accessories which are:

(a) unsafe;

(b) potentially not compliant with Australian standards; and

(c) not designed as an integral part of the vehicle and so diminish the vehicle durability, leading to early fatigue and damage to vehicles (which would be unexpected by the vehicle user).

The FCAI believes the LCT Act should be amended to exclude accessories from the LCT calculation due to the safety issues raised above.

3. Application of GST to dealer incentives

The third specific area that we would like to touch on is the application of the GST to incentives in the motor vehicle industry. In 2013 the Full Federal Court considered the AP Group case relating to particular incentives in the motor vehicle industry and the appropriate GST treatment of those incentives. The decision of the Court, whilst definitive for the six particular incentives at issue in the case, has led to great uncertainty for the motor vehicle distributors, motor vehicle dealers and the Australian Tax Office.

The motor vehicle industry internationally provides incentives and rebates in the main to improve the movement of specific vehicles and overall sales volume. As a result of the Full Federal Court decision, and subsequently an ATO Decision Impact Statement and a GST Tax Ruling (2014/1),

dealers and distributors are unable to determine with certainty if the myriad of incentives and rebates at play in the automotive market are subject to GST or not. Whilst the AP Group case decided the question of whether GST applied to the specific incentives in that case, the case does not give any clear guidance on the principles to be applied to incentives generally. Given the varied nature of incentives, this potentially creates a situation for the industry which is not only prejudicial, but potentially unworkable. In view of the significant amount of incentives paid in Australia, the industry needs certainty in respect of GST treatment of incentives generally.

The ATO has been supporting industry in ensuring that as far as possible they are able to provide rulings on any particular incentive. However, all parties acknowledge this is far from an efficient business practice, and leads to a great deal of uncertainty in both distributors and dealerships. The industry is fast moving, and new initiatives are often developed for immediate needs. Facing a situation where there is no overall policy guidance, but rather specific consideration of every alternative by external parties (i.e. the ATO) is counter to business efficiency and reduced red-tape.

FCAI has spoken to all states and territories about the situation the industry faces following the AP Group case and overall they have indicated support for our proposed amendment to the GST legislation to return the pre-AP Group status – that is all incentives are subject to GST. The Federal Government, whilst acknowledging the situation, have to date been non-committal, which given the drive for reduced red-tape and certainty in business the FCAI finds difficult to fathom. Importantly, the FCAI proposal does not reduce the GST base. If anything, returning to the situation where all incentives are taxable, the GST base is increased.

FCAI have also prepared suggested legislative changes that align with the current wording of S134 of the Act and provided this to the Federal Government to assist in drafting any legislative changes. A copy of this proposed legislation is at Appendix B. We would ask that the Tax White Paper Task Force include this specific issue in their deliberations. FCAI understands that practically, this amendment should only impact the motor vehicle industry.

Further, an unintended consequence of the Full Federal Court decision is that the calculation of luxury car tax (LCT) is impacted due to the way LCT is determined. Whether and to what extent LCT applies can only be ascertained if the GST status of the particular incentives or rebates are known, and this cannot be ascertained by the declared date, aside from the fact that the actual methodologies individual companies choose to apply to incentivise dealers is a dynamic equation. FCAI has also suggested amendments to the LCT legislation in Appendix C. Please bear in mind that this proposal is a secondary proposal to that mentioned in the early parts of this submission, which is that the LCT should be abolished.

4. Fringe Benefits Tax

Another area of interest to our sector is the Fringe Benefits Tax (FBT). This taxation arrangement drives affordability of a range of vehicles for many types of individuals including those who work in the not for profit and community service sectors. The FCAI made its case clearly to the former Government in 2013 when the removal of the statutory formula approach for the determination of the FBT liability was proposed. The statutory formula methodology remains an option and must continue as a key element of the overall FBT system.

The discussion paper tends to indicate that the largest FBT benefits go to those on the highest incomes. The FCAI research indicates in fact that the majority of beneficiaries of the FBT arrangements for motor vehicles are not those on excessively high incomes. Nor, it should be said, are the arrangements focused on purchases of expensive vehicles. The FCAI have significant data on the actual application of the concession should the Task Force require further information.

To provide additional context to our submission the following is a short summary of the history and current status of the tax as it applies to motor vehicles.

The Fringe Benefits Tax (FBT) was introduced on 1 July 1986 to improve the fairness of the tax system. It was designed to overcome deficiencies in the taxation framework that allowed benefits other than salary and wages to be tax-free income.

Currently, the FBT is imposed on benefits provided by an employer to an employee, deemed to be part of the employee's employment arrangement and a substitution for remuneration and generally are of a private nature. The tax is imposed on the employer, at the prevailing maximum marginal rate of tax. Fringe benefits are disclosed on an employee's annual payment summary. The tax is calculated on the value of the benefit provided and has a separate and distinct reporting period, being, 1 April to 31 March. Generally, employers reduce the employee's wage to cover the cost of benefits provided.

Benefits include employer paid airport lounge memberships, travel, the provision of a vehicle, the provision of car parking and employer paid loans. Where offered, employees are able to salary sacrifice such benefits through an employer sponsored salary packaging arrangement.

The *Fringe Benefits Tax Assessment Act 1986* has been amended on a number of occasions to capture more benefits subject to the tax including family travel and laptop computers.

The framework provides a range of exemptions and concessions in relation to vehicles. These include, vehicles specifically used for employment purposes such as taxis, and trade vehicles, including cab utilities, and for emergency services and health workers.

The Australian Government's (2015) tax discussion paper assumes the FBT will continue as a part of the taxation framework, indicating that as part of imposing budget repair initiatives the FBT will be taxed at the new maximum marginal rate of 49 per cent for the next two years. The paper also indicates that FBT contributes approximately 1.2 per cent to total tax revenue.

In relation to motor vehicles, two methods are available to calculate the annual obligation: the operating cost method, and the statutory method. In summary, the operating cost method is a derivative of the annual operating costs of the vehicle, including amortisation and/or depreciation, repairs and maintenance, roadside assist insurance and other insurances, and the percentage of private versus business use. This method requires a log book to be kept to determine the percentage of business versus private use. The statutory method applies a flat 20 per cent to the original cost together with a private versus business usage derivation. Whilst a more complex and record keeping intensive approach, the operating cost method would generally generate a higher level of rebate than the simpler statutory method.

A key issue with the FBT has been a lack of understanding of the legislation and compliance framework across the board, particularly in respect to small businesses. This was highlighted in a report by the Auditor General (1999) that indicated that due to the complexity of the framework, there was substantial non-compliance and errors, including by both employers and the ATO. This was highlighted by the Australian National Audit Office to Parliament's Joint Committee of Public Accounts and Audit (2000, p. 15) when it reported that approximately 50 per cent of employers did not understand their FBT obligations. The Committee noted that complexity was a significant contributor to non-compliance. In evidence before the Committee, the ATO acknowledged the FBT has high compliance costs primarily resulting from record keeping requirements. This acknowledgement related in part to the application of the operating cost method for vehicles.

More recently, whilst some amendments were made to the calculation methodology in the lead up to the 2011/2012 budget, the previous Labor Government proposed eliminating the statutory method. The proposal was met with substantial adverse public reaction, particularly from the salary packaging industry.

Whilst the ATO, tax professionals and others have provided many guides on record keeping and calculations, employers are required to have in place data capture processes in order to meet their obligations. In respect to vehicles for instance, data on all operating costs, including repairs and maintenance, log books (where the operating cost method is adopted) and in respect to car parking, data as to whether the vehicle is parked each day for periods greater than four hours (an exemption applies where the vehicle is parked for periods of less than four hours) must be kept. Record keeping and data collection processes are intensive and costly.

Recognising the FBT will remain a feature of the tax system, and against a background of the Government's desire to have a simpler and fairer system, ***the operating cost method for calculating FBT obligations in respect to vehicles could be withdrawn.***

5. Automotive Tariffs

Ford Motor Company of Australia, GM-Holden and Toyota Motor Corporation of Australia have advised that they will collectively cease domestic manufacturing of motor vehicles from the end of 2017. While this is likely to have dire consequences on local employment and investment and is a sad day given the history of innovation in automotive manufacturing in Australia it must be acknowledged that there will no longer be any need for a Customs Tariff on the imports of new motor vehicles.

The FCAI suggests that this should be a consideration in this discussion paper and that import tariffs on new motor vehicles must be reduced to zero on 1 January 2018.

At this point the FCAI will limit our comments to the issues raised above. Should you require any further information please contact our office and we will assist in any way we can.

Yours sincerely

Tony Weber
Chief Executive

Appendix A Luxury Car Tax

1.1 Background

A luxury vehicle sales tax was first introduced in Australia in August 1986 as part of the then Wholesale Sales Tax (WST), with the rate of WST on luxury vehicles rising from the standard WST rate on cars of 20 per cent to 30 per cent (Industry Commission, 1990, p. 166). The threshold on the luxury vehicle WST rate was set by reference to the motor vehicle depreciation limit for income tax purposes (Pearce, 2013, p. 703). The depreciation limit was introduced in 1979 so that depreciation could only be claimed on vehicles priced below the limit.

The rate of WST on luxury cars was subsequently increased to 50 per cent in May 1990 (Industry Commission, 1990, p. 166). Then, in August 1990, a split rate tax structure was introduced with sales tax payable on luxury vehicles being the lesser of:

- 50 per cent; or
- 30 per cent up to the statutory threshold and 75 per cent on the value above the threshold.

In 1993 the WST was amended so the general rate of WST was applied to that amount of a luxury car price that was under the luxury threshold while that portion that exceeded the threshold was taxed at the rate of 45 per cent (Pearce, 2013, p. 703).[3]

The current luxury car tax (LCT) was borne out of political expediency by the Howard Government during the transition from the abolition of the WST to the introduction of the Goods and Services Tax (GST) as outlined in the explanatory memorandum for the legislation:

> The main objective is to ensure that the price of luxury cars will fall under the new arrangements by about the same amount as a car just below the luxury car tax threshold. (Australian Government, 1999)

Essentially, the LCT was designed with the intention of maintaining the relativities between car prices following the abolition of the WST and the introduction of the GST.

Without much justification for its decision to impose the LCT, the Howard Government declared:

> Cars in general will fall in price as a result of the change from the wholesale sales tax to the GST. If the Government took no specific action, then the price of luxury cars would fall dramatically as they are currently subject to the special wholesale sales tax rate of 45% to the value above the luxury car tax threshold. The Government does not believe that this price reduction is appropriate following the replacement of the wholesale sales tax with the GST. Therefore, the Government will impose a retail tax on luxury cars ... (Australian Government, 1999)

For the purposes of the application of the LCT, a *luxury car* is defined in terms of whether the value of the car exceeds the LCT threshold. A car is defined as a motor vehicle (except a motor cycle or similar vehicle) designed to carry a load of less than 2 tonnes and fewer than 9 passengers or limousine (regardless of the number of passengers it is designed to carry). There are exemptions for

[3] The general rate of WST applicable to cars progressively increased from 16 per cent in August 1993 to 21 per cent in May 1995, and then to 22 per cent in July 1995.

emergency vehicles, specially fitted out for transporting disabled people in wheelchairs, a commercial vehicle that is not principally designed to carry passengers, or a motor home or campervan. The LCT does not apply if the vehicle is more than two years old. The LCT threshold is set inclusive of GST and was initially set equal to the motor vehicle depreciation allowance.

Originally, the LCT was applied at a rate of 25 per cent on the GST exclusive value above the LCT threshold. However, the rate was increased to 33 per cent by the Rudd Government as part of its 2008-09 Budget. The then Treasurer Wayne Swan (2008) justified the decision to raise the LCT rate on the basis that the rate hadn't been increased since the LCT was first introduced in 2000 and that those who had the financial capacity to afford a luxury car could afford the additional impost:

> The luxury car tax was introduced in 2000 when the goods and services tax (GST) was introduced and the wholesale sales tax abolished. Since that time there has been no change to the luxury car tax rate.
>
> The Government now considers an increase in the luxury car tax rate to be appropriate. The Government believes that Australians who can afford luxury vehicles have the capacity to contribute to revenue at a higher rate than other car buyers. This is part of the Rudd Government's plans to make the tax system fairer.

In order to secure passage for the increase in the LCT rate through the Senate, the Rudd Government agreed to an amendment by the Australian Greens that the LCT would not apply to cars under $75,000 in price if they used no more than 7 litres of fuel per 100 kilometres. The Rudd Government also agreed to amendments by Family First Senator Steve Fielding to exempt primary producers and tourism operators from the increased rate. This was enacted through the payment of refunds to primary producers and tourism operators for the LCT paid on the purchase of cars. Furthermore, the Rudd Government agreed to an amendment from Senator Nick Xenophon to change the method for indexing the LCT threshold from the beginning of the 2012-13 financial year, thereby breaking the nexus between the LCT threshold and the motor vehicle depreciation limit. The method by which the LCT threshold was set is considered below.

1.2 Indexation of the Luxury Car Tax Threshold

Prior to 1 July 2012, the luxury car tax threshold (along with the motor vehicle depreciation allowance) was indexed based on annual movements in the motor vehicle purchase component of the consumer price index (CPIMV) in previous financial years.[4] In measuring rises in the consumer price index (CPI), so that it can measure changes between 'like' products with 'like' products, the Australian Bureau of Statistics (ABS) makes adjustments to prices when there has been a change in product quality. Because there is a continuing increase in the number of additional features added to motor vehicles, the ABS continually adjusts down the price of motor vehicles to account for the ongoing improvements in quality. As the ABS (2011, p. 31) notes:

[4] For example in the 2010-11 financial year, the LCT threshold that existed in 2009-10 was multiplied by an indexation factor of 1.005 based on a ratio of an annual CPIMV index of 415.8 in 2009-10 and an annual index of 413.6 in 2008-09.

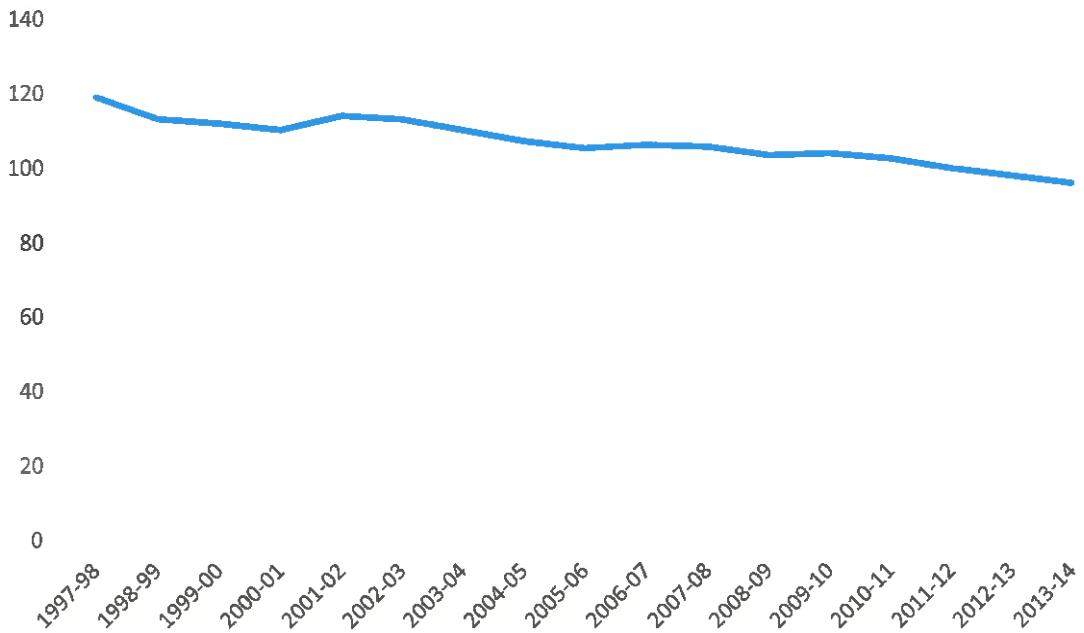
> For some items quality change over time is not a major issue (e.g. the quality change in apples might only reflect differences in growing conditions between seasons), but for other items quality changes are very important (e.g. the increase in power and speed of laptops, and changes in safety and fuel efficiency of motor vehicles).

This has meant that while the cost of vehicles actually rises over time, the CPIMV in trend terms actually falls. This problem was articulated by the Senate Standing Committee on Economics (2008, p. 6) in the following terms:

> There has been a steady increase in the features of car models (either adding entirely new features or features formerly available only as options at additional cost now being standard). As a result, although the listed price of a standard 'family 6' sedan has risen, the CPIMV has fallen.

The CPIMV index is outlined below in Figure 1.

Figure 1: Year average index numbers for the motor vehicle purchase component of the consumer price index – 1997-98 to 2013-14



Source: Australian Bureau of Statistics (2015)

In a very minor concession, the LCT threshold was only raised when the CPIMV actually increased.

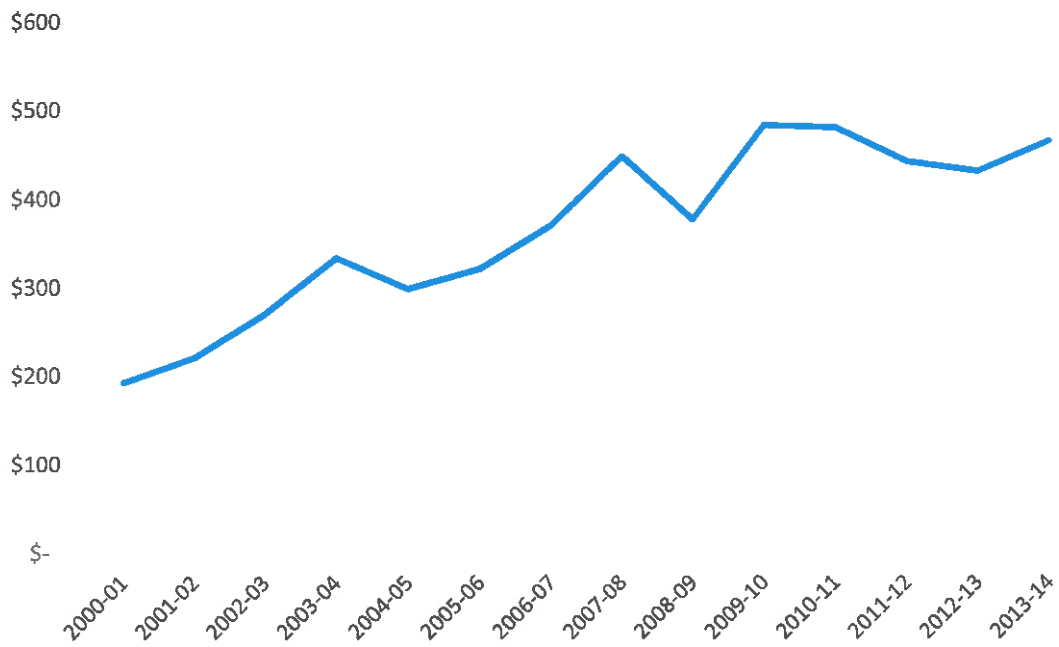
Because of price increases due to the addition of more features, vehicles whose price is on the cusp of the luxury car tax threshold were likely to 'creep' past the threshold through time. Bracket creep is where people moving into higher tax brackets purely because the tax thresholds are not (fully) adjusted for inflation, which means that at the same real income a larger proportion is paid in tax (Buddelmeyer, Dawkins, Freebairn, & Kalb, 2004, p. 3). In relation to the how the threshold of the LCT was originally indexed, this phenomenon is perhaps appropriately described as threshold creep.

As the current editor of *The Australian Financial Review* Michael Stutchbery (2008) previously observed in relation to indexation through the CPIMV:

> ... more and more car lovers have been conscripted into the luxury tax net by a form of indexed bracket creep.

Fiscal drag describes the phenomenon whereby more people move into higher tax brackets because thresholds are not adjusted in line with inflation (Lee, 2012, p. 179). If the reference to 'people' is substituted with 'vehicles', then fiscal drag accurately describes what has happened with the application of the LCT since its introduction on 1 July 2000. As can be seen in Figure 2 below, revenue generated by the LCT was trending upwards until the global financial crisis in 2008 and appears to have plateaued in nominal terms since that time.

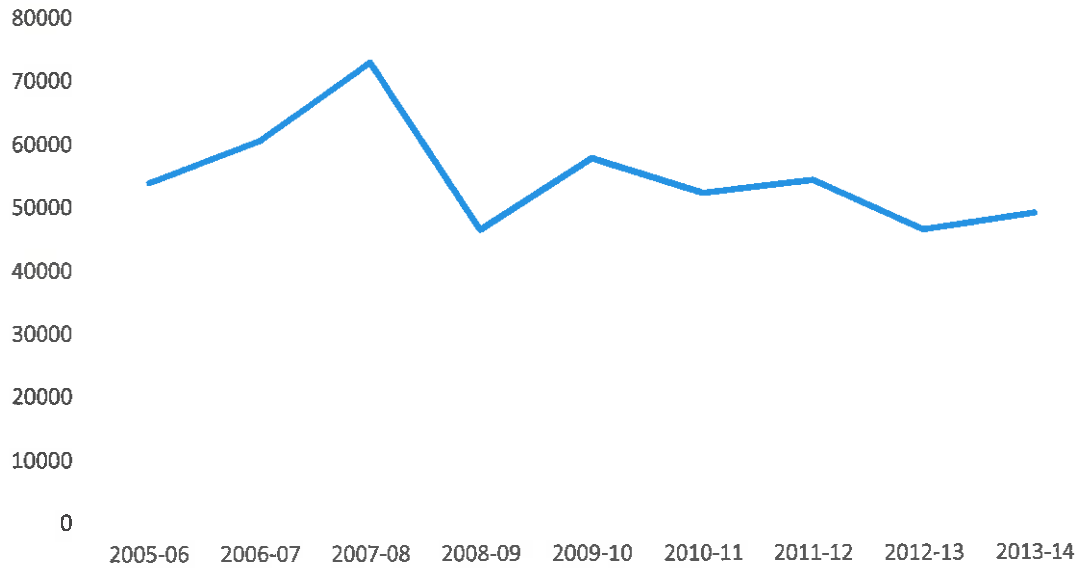
Figure 2: Tax revenue generated by the Luxury Car Tax, 2000-01 to 2013-14 ($ million)



Sources: Hockey & Cormann (2014, p. 5); Australian Taxation Office (2014)

Prior to the increase in the LCT rate in 2008-09, the onset of the global financial crisis in the latter half of 2008, and the change in the method indexation for the LCT threshold beginning in 2012-13, an increasing number of vehicles were being dragged into the LCT as outlined below in Figure 3.

Figure 3: Number of vehicles subject to the Luxury Car Tax, 2005-06 to 2013-14



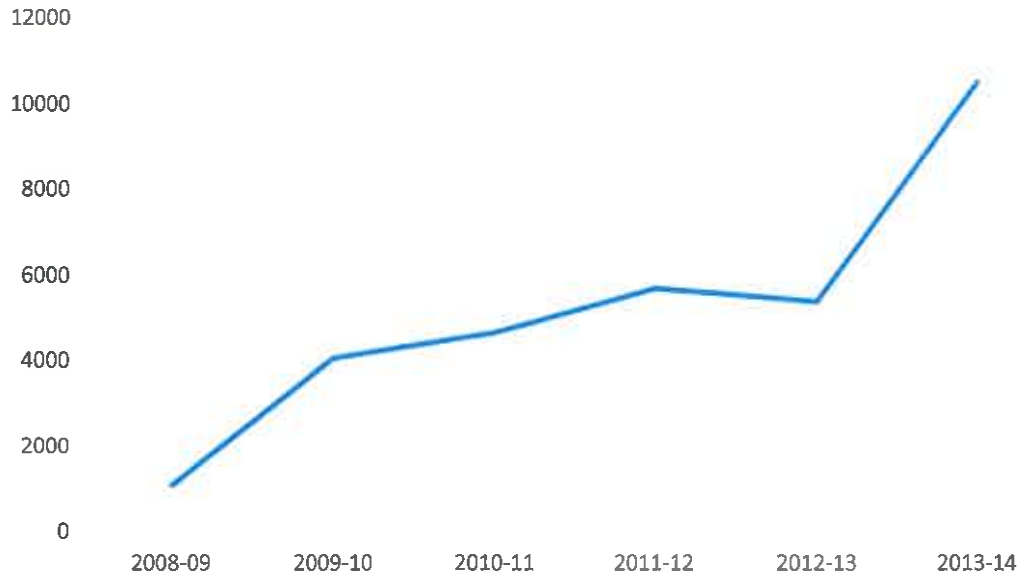
Source: VFACTS database

The Industry Commission (1997, p. 114) estimated in 1995 that around 3 per cent of new passenger motor vehicle sales were subject to the WST luxury tax. The percentage of passenger vehicle sales subject to the LCT peaked at 8.6 per cent in 2007-08 and has since fallen back to 5.5 per cent in 2013-14.

From July 2012 the general LCT threshold has been indexed annually according to a factor to be determined by Parliament or, if such a factor is not determined by Parliament, indexed annually in accordance with movements in the All Groups CPI. Since this time, the LCT threshold has been indexed by the All Groups CPI.

However, bracket creep is now clearly evident in the LCT threshold for fuel efficient vehicles that hasn't been indexed since 2010-11 resulting in an increasing number of such vehicles falling into the LCT net as outlined below in Figure 4.

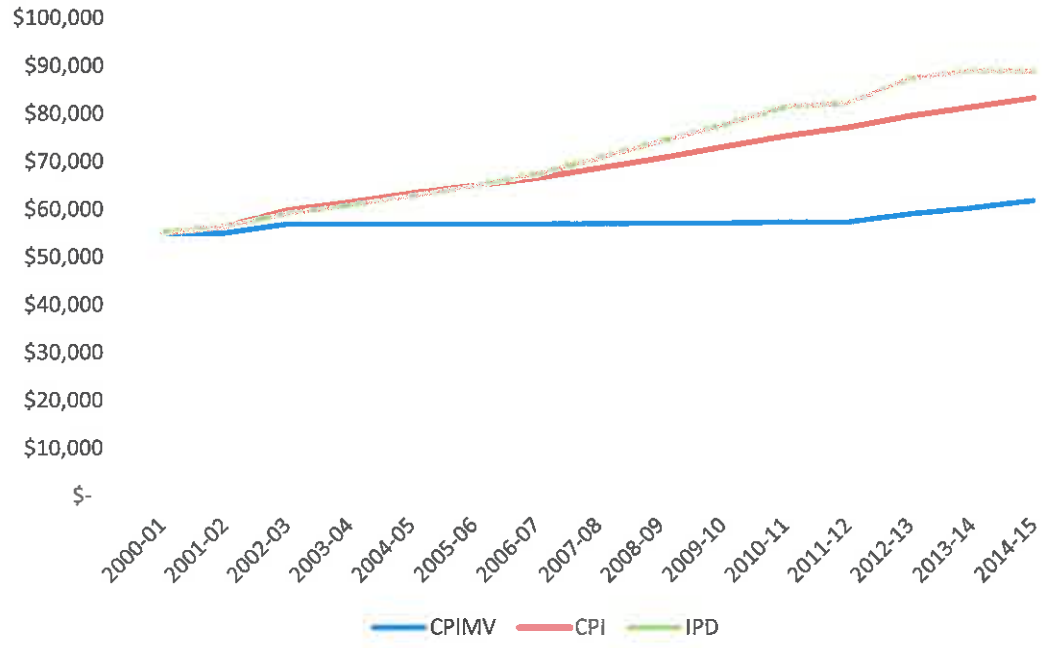
Figure 4: Number of fuel efficient vehicles subject to the Luxury Car Tax, 2008-09 to 2013-14



Source: VFACTS database

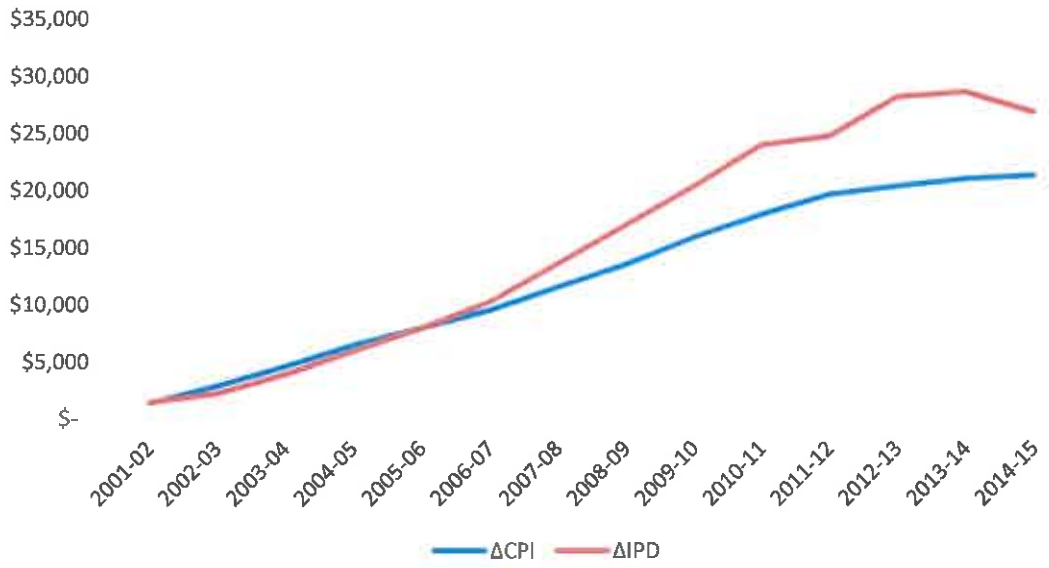
If the LCT threshold had been indexed by more common measures of inflation from its commencement, such as the All Groups CPI or the implicit price deflator (IPD) on gross domestic product (GDP), the threshold would be more than $20,000 higher in 2014-15 than it currently is. This is outlined in Figure 5 and Figure 6 below.

Figure 5: Actual Luxury Car Tax threshold versus indexation by the All Groups CPI and the implicit price deflator on GDP, 2000-01 to 2014-15 ($)



Source: Australian Bureau of Statistics (Australian Bureau of Statistics, 2015); (Australian Bureau of Statistics, 2015a)

Figure 6: Difference between Luxury Car Tax Threshold if it had been indexed by the All Groups CPI and the implicit price deflator on GDP ($)



1.3 Principles of Taxation

Taxation and government charges provide governments with the means to provide goods and services and to redistribute income. However, most taxes distort production and consumption decisions, causing inefficiencies in the allocation of resources, thereby imposing costs in excess of the revenue raised. The excess burden of taxation, also known as the distortionary cost or deadweight loss of taxation, is the economic loss that society suffers as the result of a tax, over and above the revenue it collects. In the case of a tax on a good, consumers will buy less of the good because of the higher price and producers will receive less on the sale of the good, and hence, reduce supply of the good. The excess burden of taxation represents the lost value to consumers and producers due to the reduction in the sales of the good or service, but not captured by government revenue.

The impact of taxes have prompted economists and social philosophers to consider principles or criteria for design and assessment of taxation systems. Since Adam Smith (1961) originally proposed four "canons of taxation" (which he called maxims) back in 1776, economic and political analysts have further developed and refined these canons to provide a core set of principles of taxation that have become widely accepted. These principles can be briefly summarised as equity, economic efficiency and administrative efficiency (or simplicity).

Some discussions of tax system design principles tease out the three core principles into sub-principles and/or add other principles. The 2001 Nobel Laureate for economics Joseph Stiglitz (2000, pp. 457-458) observed there were five accepted properties of a 'good' tax system:

- Economic efficiency: the tax system should not interfere with the efficient allocation of resources
- Administrative simplicity: the tax system ought to be easy and relatively inexpensive to administer
- Flexibility: the tax system ought to be able to respond easily (in some cases automatically) to changed economic circumstances
- Political responsibility: the tax system should be designed so that individuals can ascertain what they are paying, and evaluate how accurately the system reflects their preferences
- Fairness: the tax system ought to be fair in its relative treatment of different individuals.

The Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 17) established by the Rudd Government articulated the following design principles for the tax-transfer system in its final report:

- Equity
- Efficiency
- Simplicity
- Sustainability
- Policy consistency.

The first, second and third of these principles are the core principles of taxation - equity, economic efficiency, administrative efficiency - that have become widely accepted. The fourth principle, sustainability, reflects the basic purpose of taxation and government charges, which is to provide resources for government programs and to redistribute income. Sustainability also means that the structural features of the system should be durable in a changing policy context, yet flexible enough to allow governments to respond as required (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 17). The fifth principle, policy consistency, refers to tax policy being internally consistent, with the adoption of rules in one part of the tax not contradicting rules in another part of the system (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 17).

The underlying economic principles that appears to have guided the Henry Tax Review is that raising revenue from taxes should be broadly based and avoid as much as possible distorting individuals' choices with the exception of taxes which are precisely targeted towards correcting market failures. A primary goal was to minimise adverse effects on the allocation of resources.

The LCT will be assessed below against the five design principles as articulated by the Henry Tax Review.

1.3.1 Equity

Economics is generally unable to provide definitive answers on the policy question of whether it is desirable for governments to pursue equity through engaging in income redistribution. This is because definitive answers require a subjective assessment of the detriment done to those who have income redistributed away from them which in turn has to be offset against the benefit received by those for whom income is redirected towards. Economists often regard such assessments as value judgements outside the realm of economics. On the other hand, governments generally have no such qualms in presiding over a tax transfer system that engages in the redistribution of income that is often justified on the basis of reducing the suffering of the poor and alleviating poverty.

Equity is often considered in terms of two dimensions:

- Horizontal equity – individuals having the same ability to pay contribute equally
- Vertical equity – individuals having higher abilities to pay contribute more than those with lower capacities.

In terms of achieving greater equity through the redistribution of income, the LCT has been regularly criticised as an ineffectual policy instrument. According to the Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 58):

> The luxury car tax discriminates against a particular group of people because of their tastes. It is a complex and ineffective way of redistributing income from rich to poor.

The Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, p. 475) was of the view that Australia's comprehensive tax system coupled with a sophisticated transfer system was a far superior instrument for the redistribution of income than the LCT (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, p. 475). According to the review, luxury taxes violate both the principles of horizontal and vertical equity.

Horizontal equity requires people of the same means to pay the same amount of tax. Luxury taxes violate horizontal equity because wealthy people with modest tastes pay less tax than wealthy people with a preference for luxury goods. Vertical equity requires that people of greater economic means should pay more tax. Luxury taxes violate vertical equity because very few luxury goods are the exclusive preserve of the wealthy (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, p. 475).

The Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, pp. 475-476) declared that luxury taxes were an ineffective and arbitrary means of redistributing economic resources and recommended the abolition of the LCT.

There is ample evidence in support of the position taken by the Henry Tax Review in relation to luxury taxes. According to *The Encyclopedia of Taxation & Tax Policy*:

> Luxury taxes ... create horizontal inequities among taxpayers in the same income (or consumption) class when taxpayers have different tastes (Davie & Zimmerman, 2005, p. 246).

Where governments have other tax and transfer mechanisms at its disposal to pursue income redistribution, the imposition of luxury taxes on cars is seen as poor proxy through which to pursue income redistribution. According to Crawford, Keen and Smith (2008a, p. 9):

> The optimal design of such tax structures has received substantial attention ... One key insight ... is that the case for such rate differentiation is weaker the greater is the government's ability to pursue its distributional objectives by other means, including, but not only, by taxing (or subsidising) income. The central point is that differential commodity taxation is a very blunt instrument for the pursuit of equity objectives ...

Similarly, Hines (2007, p. 66) has observed:

> Excise taxes on luxury items ... are generally less effective, and indeed never more effective, at redistributing income than are income tax alternatives.

According to a paper prepared by Clarke and Prentice (2009, p. 27) for the Henry Tax Review specifically in relation to the LCT:

> ... the rationale appears to be to introduce a type of progressivity into commodity taxation. However, this is dubious at best because only one luxury good among the many are likely to be purchased by high-income earners is taxed. The LCT is likely ... to distort consumers' choices away from purchasing luxury cars and either towards less luxurious cars or purchasing other luxury items.

The LCT fails on equity grounds.

1.3.2 Efficiency

If the LCT cannot be justified on equity grounds, then it needs to be considered as to whether it can be justified on efficiency grounds.

Allocative efficiency is where resources used to produce a set of goods and services are allocated to their highest valued uses (ie those that provide the greatest benefit relative to costs) (Hilmer, Rayner, & Taperell, 1993, p. 4). Economists are concerned with an efficient allocation of resources because resource misallocation can lead to reduced income growth for society at the aggregate level (more commonly referred to as economic growth). Resource misallocation means that resources have been directed away from more profitable and sustainable economic pursuits into less profitable and less viable activities which detracts from overall economic growth and reduces welfare. In an imperfect world, resource allocation inefficiencies are inevitable and elimination of all inefficiencies is not a practically achievable objective. In this case, the optimal policy response is generally taken to be the *minimisation of aggregate inefficiencies subject to the various constraints.* In practical terms, this essentially means comparing two alternative situations and deciding which one is preferable from an economic perspective.

Taxes generally distort consumption because they change relative prices within the economy which is known as a substitution effect. The excess burden of taxation arises when taxpayers are induced to make substitutions in order to ameliorate the impact of a tax (Watson, 2005, p. 121). These substitutions suggest that taxpayers are making choices, which in the absence of the tax, would be considered inferior. These inferior choices are the source of the excess burden. For this reason, the Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 18) noted:

> When products are taxed at the same rate, relative prices will be unaffected and there will be less impact on the decisions of individuals and businesses. A broad base also enables a lower rate of tax for a given revenue objective, which results in smaller distortions to people's and businesses' choices. Broadly-based taxes are, therefore, more consistent with an allocation of resources in the economy that supports a high rate of economic growth and individual satisfaction.

To determine whether a tax creates an excess burden, it is only necessary to determine whether it alters any ratio of prices. Given the discriminatory nature of the LCT for cars over the LCT threshold, it dramatically alters the ratio of prices between cars under and above the threshold. On this basis, the Productivity Commission (2014, p. 104) concluded:

> Because it is levied on a narrow base, the LCT is a higher-cost and less efficient method of raising revenue than more broadly based taxes.

In particular, the operation of the LCT threshold inevitably distorts consumer preferences for those consumers that find themselves making choices at the threshold and who opt to purchase cheaper cars to avoid paying the LCT, leading to a welfare loss in terms of consumer surplus (McPherson, Guffogg, Takemoto, & Williams, 2011, p. 20).[5]

The excess burden of taxation is measured through two mechanisms, the average cost of funds or average excess burden and the marginal cost of funds or marginal excess burden. The average excess burden is the total cost of the distortion divided by the total tax revenue collected by government. The marginal excess burden is the size of the distortion that accompanies the last unit of revenue raised.

Clarke and Prentice (2009, p. 27) estimated the marginal excess burden from the LCT could be up to 30.8 cents in the dollar. KPMG Econtech (2010) estimated the marginal excess burden at 20 cents in the dollar and the average excess burden at 9 cents in the dollar for the LCT. While KPMG Econtech (2010, pp. 5-6) rated the excess burden of the LCT as medium which was less than labour income tax, it noted the excess burdens were likely to be an under-estimate because the modelling could not capture the point at which the luxury car tax distorted the choice between luxury and non-luxury cars.

There are a limited number of cases where a luxury tax could be justified on efficiency grounds. Goods are generally purchased because of the satisfaction or utility one derives when the good is consumed. However, if the good is a status good, then part of the satisfaction one derives from its consumption is due to its effects on other individuals. According to Miller (1975, p. 144):

> ... by definition a status good is purchased because of its effect on other individuals ... In general the effects would be considered undesirable by the affected persons. Those who do not have the status symbol are made to feel inferior. Those who already have one find the prestige accruing to them reduced when another person acquires one.

According to Miller, the existence of a status good may encourage too much production and consumption of a good from a social point of view. In this case, the imposition of a tax can serve to shift the pattern of production back down towards a more socially desirable level. Thus a reduction in consumption due to an excise tax does not necessarily indicate the existence of an excess burden since the pre-tax level of the status good may have been excessive (Miller, 1975, p. 146). According to Millar (1975, pp. 152-153), where goods are purchased for status reasons, taxes on the status value of the good improves resource allocation and thus in practice luxury taxes are not guilty of creating the excess burden that many economists accuse them of. While concerns regarding

[5] Consumer surplus is the amount that consumers benefit by being able to purchase a product for less than what they would be prepared to pay

excessive production and consumption of status goods has merit in economic theory, the information requirements would often preclude the imposition of such a tax in practice.

Economic rent is defined as an excess distribution to any factor in a production process above the amount required to draw the factor into the process or to sustain the current use of the factor. True economic rent can be collected by governments for the purpose of public finance without the adverse effect caused by taxes on production or consumption.

The Veblen effect refers to the phenomenon of conspicuous consumption where demand for a good increases because it bears a higher price rather than a lower price (Leibenstein, 1950, p. 189). It is named after American economist and sociologist Thorstein Veblen (Thorstein, 1899) who referred to the conspicuous consumption of a leisure class that lived on the profits of business. Leibenstein (1950) differentiated between the price effect which refers to the normal reaction whereby demand rises as the price of the good falls and the Veblen effect whereby the benefit to the consumer in terms of their prestige, dignity and status falls as a result of the lower price. If the Veblen effect dominates the price effect, then the good can be described as a Veblen good which basically means it defies the law of demand.

In the case of Veblen good, the price of such goods is demand driven rather than a combination of supply and demand – which means that such luxury goods are sold at the consumer's preferred price which is tax inclusive and does not vary with the tax rate (Bagwell & Bernheim, 1996, p. 368). As long as the tax per unit does not exceed the difference between the consumer's preferred price and the marginal cost of production[6], then a tax on a Velben good amounts to a nondistortionary tax on economic rent (Bagwell & Bernheim, 1996, p. 368). One again, while this argument has merit in economic theory, the information requirements would often preclude the imposition of such an approach in practice.

Even if some cars caught by the LCT could be categorised as either status or Veblen goods, it is implausible the current threshold of the LCT accurately reflects either of these goods. As Coalition Senators on the Senate Economics Committee that reviewed the Rudd Government's increase in the LCT in 2008 remarked:

> On the evidence provided, it is clear that the Luxury Car Tax now applies to a significant number of cars which cannot be classed as 'luxury', particularly 'people-movers' used by large families, and four-wheel drives used again by large families and those in regional and rural Australia. (The Senate Standing Committee on Economics, 2008, p. 35)

An analysis of the LCT in 2013-14 reveals that sales of the Toyota Landcruiser accounted for more than 10 per cent LCT collections followed by the Range Rover Sports that account for around 7 per cent of LCT collections, with over 70 per cent of vehicles subject to the LCT costing under $100,000.

[6] Marginal cost is the cost of producing an additional unit of output or an additional unit of service. Allocative efficiency is where resources used to produce a set of goods and services are allocated to their highest valued uses (ie those that provide the greatest benefit relative to costs). The efficient pricing level (ie that which achieves allocative efficiency) is where it is equated to the marginal cost.

The policy implications of the existence of either status or Veblen goods in relation to cars would suggest the LCT threshold should be significantly higher. On this basis, the current LCT fails on efficiency grounds.

1.3.3 Simplicity

Simplicity requires the tax system to be easy to understand and simple to comply with (Henry, Harmer, Piggott, Ridout, & Smith, 2009, p. 17).

However, it would appear the LCT also struggles in relation to simplicity. According to the Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, p. 476), the design of the LCT was complex and was becoming more complex over time.

The Henry Tax Review (Henry, Harmer, Piggott, Ridout, & Smith, 2009b, p. 476) was especially critical of the different and higher threshold for the LCT as it applied to more fuel efficient cars:

> ... the current $75,000 threshold for fuel-efficient luxury cars is costly and ineffective way of limiting greenhouse gas emissions.

The definition of fuel efficient cars for the purposes of the application of the LCT has been extended by a Private Binding Ruling by the Australian Taxation Office (ATO) to cover fully electric vehicles (The Auditor-General, 2011, p. 29). A fully electric vehicle that can travel 100 km using 21.25 kilowatt hours of electricity using the Victorian electricity grid would generate 250 grams of CO_2 per km, a long way short of the requirements for petrol and diesel cars.[7] If the objective of the higher threshold for the LCT is to reduce CO_2 emissions, then Victorian purchasers of fully electric vehicles should arguably be excluded from the concession altogether.

The imposition also creates a distortion in relation to vehicles close to the LCT threshold in the car accessories market in favour of 'after market' suppliers, because the LCT is applied to accessories when included at the time of car purchase, whereas it does not apply when purchased after the vehicle is bought (McPherson, Guffogg, Takemoto, & Williams, 2011, p. 20).

The LCT does appear to be fairly straight-forward to comply with. Car dealers interviewed by the Australian National Audit Office during an efficiency audit of the LCT commented they were generally unconcerned with the cost of complying with the tax (The Auditor-General, 2011, p. 42).

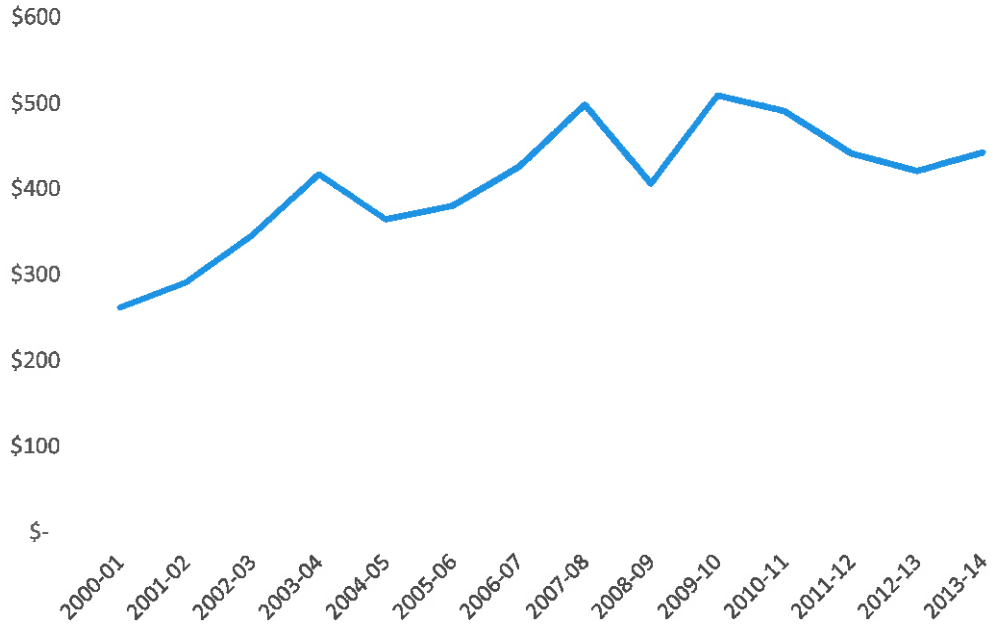
Overall, however, the LCT appears to fail on the principle of simplicity.

1.3.4 Sustainability

If sustainability is interpreted in a narrow sense as to whether revenue generated from a tax will continue to increase over time, then it is questionable as to whether the LCT is a sustainable tax. In real terms, revenue from the LCT peaked in 2009-10 as outlined below in Figure 7 and has fallen since.

[7] ibid.

*Figure 7: Revenue from the Luxury Car Tax in constant 2011-12 dollars ($ million)**



*Revenue figures deflated by the All Groups CPI

Furthermore, a potential threat is presented to the tax base of the LCT arising from the Australian Government's decision to consider possible options to reduce restrictions on the personal importation of new cars (Briggs, 2015). The Government could erode the tax base of the LCT through encouraging car purchasers to substitute locally acquired cars with inferior but superficially cheaper products from unofficial and dubious overseas sources completely lacking in any trademark protection.[8]

In terms of a broader concept of sustainability, a tax system must be accepted by the community as fair in order to be sustainable (Australian Government, 2015, p. 29). Given the LCT fails in terms of both horizontal and vertical equity as discussed above, it could hardly be considered as fair. On this basis, the LCT is not sustainable over the longer term and it is questionable as to whether it is even sustainable in a narrow sense over the medium term given revenue has tapered off in recent years in recent years.

1.3.5 Policy Consistency

The application of the LCT is completely incompatible with the rest of taxation system. With the abolition of the WST and its replacement by the GST, the LCT is the last remaining discriminatory tax imposed on a supposedly luxury good. Other supposed luxury goods that were subject to a

[8] Historically, trade mark law has existed primarily to protect against consumer deception that occurs when one party attempts to pass off its products as those of another (Dogan & Lemley, 2005, p. 463). The overriding problem with parallel imports of cars is the direct link between the trade mark owner's product and the consumer has been broken because some extraneous third party has broken the nexus. As the trade mark owner can longer guarantee the quality of a parallel imported vehicle, this leaves the consumer vulnerable to the risk of purchasing a 'lemon' or defective vehicle.

discriminatory WST rate were not subjected to any discriminatory tax on top of the GST following the abolition of the WST (Pearce, 2013, p. 704).[9] As Stutchbury (2008) has pointed out:

> There is no luxury tax on expensive boats, private jets, jewellery, price-hyped Bill Henson photo art or luxury holidays.

Even Labor Senators on the Senate Economics Committee in 2008 that reviewed the Rudd Government's LCT rate increase acknowledged the lack of consistency in the taxation of luxury goods:

> The committee sees some merit in the argument that it is 'unfair' that luxury cars are taxed but not other luxury purchases such as yachts or expensive artworks and jewellery. (The Senate Standing Committee on Economics, 2008, p. 17)

The LCT fails on policy consistency.

1.4 Compliance issues

For compliance purposes, the LCT utilises the same administrative framework as the GST with LCT liabilities accounted for in a GST registered entity's Business Activity Statement (BAS) (The Auditor-General, 2011, p. 30). Car manufacturers and dealers in luxury cars will have an Australian Business Number (ABN), will be registered for GST and will account for LCT liabilities at specific LCT labels in their BAS returns. Importers of luxury cars are able to quote their ABN to the Australian Customs and Border Protection Service and defer payment of LCT if they intend to use the car for a quotable purpose, such as holding the car as trading stock. Quoting is a mechanism to defer LCT to a later assessable dealing or to give effect to exemption from the tax for a particular type of vehicle. LCT becomes due and payable when the luxury car is sold or it is no longer used for a quotable purpose.

For many years there have been reports of abuse within the LCT system through entities acquiring luxury cars for a quotable purpose through quoting their ABN, however, then using the vehicle for personal use. Back in 2004 there was a press report that people had avoided the LCT through obtaining wholesale motor dealer licences and in turn acquiring luxury cars for quotable purposes but using the vehicles for personal use (Brown, 2004). In 2011 there was a press report the practice had extended beyond those who have obtained a wholesale motor dealer licence, with the cars acquired for a quotable purpose being used for personal use and then off-loaded after two years when they were no longer liable under the LCT (Anderson & Grigg, 2011)

The Auditor-General (2011, p. 46) highlighted such practices in an audit of the LCT:

> GST Cash Economy audits undertaken at that time (early 2008) focused on the motor vehicle industry in South Australia. The audits found a number of instances where buyers in the market for luxury cars avoided paying LCT and/or over-claimed GST input tax credits on their purchase by engaging in evasive behaviours, such as quoting an ABN when purchasing a luxury car with no intention of holding the vehicle as trading stock. At the time, South Australia represented less than eight per cent of the overall market in luxury vehicles and, based upon these figures, the

[9] Luxury cars were specified under schedule 6 of the WST while good that were described as luxuries were specified under schedule 5 of the WST.

draft risk assessment suggested that the budget risk nationally could be greater than previously estimated.

In turn, the Auditor-General (2011, p. 56) suggested the need for the ATO to introduce additional measures to reduce the opportunity for abuse of the quoting mechanism to avoid LCT obligations.

The ATO appears to have made greater compliance efforts in relation to the LCT in recent years. The ATO (2012) responded to the Auditor-General's recommendations through transferring responsibility for managing the LCT to a risk area that specialised in managing smaller taxing schemes within the ATO to enable a better focus and management on the risk of non-compliance. The ATO also said that improvements in the use of motor vehicle registration and import data had been made for risk identification, profiling, data matching and enforcement purposes. This had resulted in improved case selection and better targeting of noncompliant taxpayers.

In a Gazette Notice issued on 7 November 2012, the ATO announced a datamatching program targeting individuals and businesses that had purchased or acquired a vehicle with a transaction value of $10 000 or greater in the 2011-2012 and the 2012-13 financial years from state and territory motor vehicle registries (Commonwealth of Australia, 2012). One of the stated objectives of the datamatching program was to address compliance behaviour in relation to the LCT. As part of this process the ATO said that it expected the records relating to approximately 2.8 million individuals would be matched.

The ATO (2012a) estimated the tax gap or level of noncompliance with the LCT at $26 million in 2009-10, and $28 million in 2010-11.

1.5 Unintended Consequences

The imposition of the LCT may have also been responsible for providing incentives for motor vehicle manufacturers/importers in Australia to offer a greater proportion of higher specification vehicles than available in other jurisdictions, in turn leading to misleading price comparisons and criticism that vehicle manufacturers/importers have been engaging in international price discrimination.[10]

The Alchian and Allen (1964, pp. 74-75) theorem, also known as the third law of demand, states that adding a fixed charge T (such as a transportation charge), when applied equally to two similar goods (high and low-quality apples), would lead to a relative increase in the consumption of the high-quality good as compared with the lower quality good. In other words, the higher quality product is consumed relatively more than the lower quality product in regions where an additional impost applies. According to McPherson, Guffogg, Takemoto and Williams (2011, p. 20):

> ... the preferences of luxury car consumers may shift from standard specification models to higher specification ones in line with the third law of demand – when the price of two substitute goods increase by the same amount per unit including LCT, there will be a shift in demand towards the higher grade goods. Empirically, retailers do offer higher specification models in Australia relative to the rest of the world.

[10] Price discrimination occurs when like goods or services are provided to different persons at different prices, the difference in price being unrelated to the cost of providing the goods or services. (Dawson, Segal, & Rendall, 2003, p. 89).

Complaints regarding international price discrimination in relation to luxury cars could be largely due to the application of the third law of demand through the imposition of the LCT.

APPENDIX B – CHANGES TO THE GST ACT

Division 134A—Incentive payments

134A-1 What this Division is about

You may have a decreasing adjustment if you make a payment to an entity that supplies something that you had supplied to that entity. The entity receiving the payment may have an increasing adjustment.

134A-5 Decreasing adjustments for payments made in relation to supplies to third parties

(1) You have a decreasing adjustment if:

(a) you make a payment to an entity (the ***payee***) that supplies a thing to another entity that:

(i) the payee acquired from you; or

(ii) the payee acquired from an entity (the ***intermediary***) that acquired the thing from you; and

(b) your supply of the thing to the payee or the intermediary:

(i) was a *taxable supply; or

(ii) would have been a taxable supply but for a reason to which subsection (3) applies; and

(c) the payment is in one or more of the following forms:

(i) a payment of money;

(ii) an offset of an amount of money that the payee owes to you;

(iii) a crediting of an amount of money to an account that the payee holds; and

(d) the payment is made in connection with, in response to or for the inducement of:

(i) the payee's supply of the thing to the other entity; or

(ii) the payee's supplies which includes the supply of the thing; and

(e) the payment is not *consideration for a supply to you.

(1A) However, subsection (1) does not apply if:

(a) the supply of the thing by the payee to the other entity is a *GST-free supply, or is not *connected with Australia; and

(b) you know, or have reasonable grounds to suspect, that the supply of the thing by the payee to the other entity is a GST-free supply or is not connected with Australia.

(2) The amount of the *decreasing adjustment is an amount equal to the difference between:

(a) the amount of GST payable on your supply of the thing to the payee or the intermediary, or that would have been payable but for a reason to which subsection (3) applies, taking into account any other *adjustments that arose, or would have arisen, relating to the supply; and

(b) the amount of GST payable on your supply of the thing to the payee or the intermediary, or that would have been payable but for a reason to which subsection (3) applies, if the consideration for the supply has been reduced by the amount of the payment made by you to the payee to the extent that the payment relates to the supply of the thing.

(3) This subsection applies to the following reasons why your supply of the thing to the payee or the intermediary was not a *taxable supply:

(a) you and the payee or you and the intermediary are *members of the same *GST group;

(b) you and the payee or you and the intermediary are members of the same *GST religious group;

(c) you are the *joint venture operator for a *GST joint venture, and the payee or the intermediary is a *participant in the GST joint venture.

(4) However:

(a) paragraph (3)(a) does not apply if the payee and the other entity are *members of the same *GST group when the payment referred to in paragraph (1)(a) is made; and

(b) paragraph (3)(b) does not apply if the payee and the other entity are members of the same *GST religious group when that payment is made.

134A-10 Increasing adjustments for payments received in relation to supplies to third parties

(1) You have an increasing adjustment if:

(a) you receive a payment from an entity (the ***payer***) that:

(i) supplied a thing to you; or

(ii) supplied a thing to an entity (the ***intermediary***) that supplied the thing to you,

that you supplied to another entity; and

(b) your acquisition of the thing from the payer or the intermediary:

(i) was a *creditable acquisition; or

(ii) would have been a *creditable acquisition but for a reason to which subsection (3) applies; and

(c) the payment is in one or more of the following forms:

(i) a payment of money;

(ii) an offset of an amount of money that you owe to the payer;

(iii) a crediting of an amount of money to an account that you hold; and

(d) the payment is made in connection with, in response to or for the inducement of:

(i) your supply of the thing to the other entity; or

(ii) your supplies which includes the supply of the thing; and

(e) the payment is not *consideration for a supply from you.

(1A) However, subsection (1) does not apply unless your supply of the thing to the other entity:

(a) was a *taxable supply; or

(b) would have been a *taxable supply but for any of the following:

(i) you and the other entity being *members of the same *GST group;

(ii) you and the other entity being members of the same *GST religious group;

(iii) you being the *joint venture operator for a *GST joint venture, and the other entity being a *participant in the GST joint venture.

(2) The amount of the *increasing adjustment is an amount equal to the difference between:

(a) the amount of GST payable on your supply of the thing to the other entity, or that would have been payable but for a reason to which subsection (1A)(b) applies, if the consideration for the supply had been increased by the amount of the payer's payment to you to the extent that the payment relates

to the supply of the thing, taking into account any other *adjustments that arose, or would have arisen, relating to the supply; and

(b) the amount of GST payable on your supply of the thing to the other entity, or that would have been payable but for a reason to which subsection (1A)(b) applies.

(3) This subsection applies to the following reasons why your acquisition of the thing from the payer or the intermediary was not a *creditable acquisition:

(a) you and the payer or you and the intermediary are *members of the same *GST group;

(b) you and the payer or you and the intermediary are members of the same *GST religious group;

(c) you are the *joint venture operator for a *GST joint venture, and the payer or the intermediary is a *participant in the GST joint venture.

(4) However:

(a) paragraph (3)(a) does not apply if you and the other entity are *members of the same *GST group when the payment referred to in paragraph (1)(a) is made; and

(b) paragraph (3)(b) does not apply if you and the other entity are members of the same *GST religious group when that payment is made.

134A-15 Attribution of decreasing adjustments

(1) If:

(a) you have a *decreasing adjustment under section 134A-5; and

(b) you do not hold a *third party adjustment note for the adjustment when you give to the Commissioner a *GST return for the tax period to which the adjustment (or any part of the adjustment) would otherwise be attributable;

then:

(c) the adjustment (including any part of the adjustment) is not attributable to that tax period; and

(d) the adjustment (or part) is attributable to the first tax period for which you give to the Commissioner a GST return at a time when you hold that third party adjustment note.

However, this subsection does not apply in circumstances of a kind determined by the Commissioner, by legislative instrument, to be circumstances in which the requirement for an adjustment note does not apply.

Note: For the giving of GST returns to the Commissioner, see Division 31.

(2) This section does not apply to a *decreasing adjustment of an amount that does not exceed the amount provided for under subsection 29-80(2).

(3) This section has effect despite section 29-20 (which is about attributing adjustments).

134A-20 Third party adjustment notes

(1) A third party adjustment note for a *decreasing adjustment that you have under section 134A-5 is a document:

(a) that is created by you; and

(b) a copy of which is given, in the circumstances set out in subsection (2), to the entity that received the payment that gave rise to the adjustment; and

(c) that sets out your *ABN; and

(d) that contains such other information as the Commissioner determines in writing; and

(e) that is in the *approved form.

However, the Commissioner may treat as a third party adjustment note a particular document that is not a third party adjustment note.

(2) You must give the copy of the document to the entity that received the payment:

(a) within 28 days after the entity requests you to give the copy; or

(b) if you become aware of the *adjustment before the copy is requested—within 28 days, or such other number of days as the Commissioner determines under subsection (4) or (6), after becoming aware of the adjustment.

(3) Subsection (2) does not apply to an *adjustment of an amount that does not exceed the amount provided for under subsection 29-80(2).

(4) The Commissioner may determine in writing that paragraph (2)(b) has effect, in relation to a particular document, as if the number of days referred to in that paragraph is the number of days specified in the determination.

(5) A determination made under subsection (4) is not a legislative instrument.

(6) The Commissioner may determine, by legislative instrument, circumstances in which paragraph (2)(b) has effect, in relation to those circumstances, as if the number of days referred to in that paragraph is the number of days specified in the determination.

(7) A determination made under subsection (4) has effect despite any determination made under subsection (6).

134A-25 Adjustment events do not arise

To avoid doubt, a payment that gives rise to an *adjustment under this Division cannot give rise to an *adjustment event.

134A-30 Application of sections 48-55 and 49-50

(1) For the purposes of working out whether you have an adjustment under this Division, disregard sections 48-55 and 49-50.

(2) However, this section does not affect the application of sections 48-55 and 49-50 for the purposes of working out the amount of an adjustment under this Division.

Note: Sections 48-55 and 49-50 require GST groups and GST religious groups to be treated as single entities for the purposes of adjustments.

APPENDIX C – CHANGES TO THE LCT ACT

Subdivision 15-D – Incentive payment adjustments

15-50 Decreasing adjustments for payments made by third parties

(1) You have a ***decreasing luxury car tax adjustment*** if:

(a) you receive a payment from an entity (the ***payer***) that:

(i) supplied a *car to you; or

(ii) supplied a *car to an entity (the ***intermediary***) that supplied the *car to you,

that you supplied to another entity and the supply to the other entity was a supply of a *luxury car; and

(b) your supply of the *luxury car to the other entity was a *taxable supply; and

(c) the payment is in one or more of the following forms:

(i) a payment of money;

(ii) an offset of an amount of money that you owe to the payer; or

(iii) a crediting of an amount of money to an account that you hold; and

(d) the payment is made in connection with, in response to or for the inducement of your supply of the *luxury car to the other entity; and

(e) the payment is *consideration for a supply by you of the *luxury car to the other entity.

(2) The *decreasing luxury car tax adjustment is equal to the difference between:

(a) the amount of *luxury car tax payable on your supply of the *luxury car to the other entity taking into account any other *luxury car tax adjustments that arose, or would have arisen, relating to the supply; and

(b) the amount of *luxury car tax that would have been payable for that supply:

(i) if the *consideration for the supply had been reduced by the amount of the payer's payment to you; and

(ii) taking into account any other *luxury car tax adjustments that arose, or would have arisen, relating to the supply, as they would have been affected (if applicable) by such a reduction in the *consideration.