Senate Enquiry into Fringe Benefit Tax Changes

Submission by:

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Introduction

We thank the Senate Committee for the opportunity to share the Association's views on the amendments to the fringe benefit tax (FBT) in relation to company vehicles.

The Australasian Fleet Management Association Inc. (A*f*MA) is a not for profit organisation representing over 600 members across Australia and New Zealand. Members of A*f*MA are responsible for the management of an estimated 800,000 vehicles.

The Fleet Industry plays a significant role at both a Federal and State economic activity level as Fleet accounts for more than 50% of all new vehicle registrations. Purchasing decisions made by Fleets today will impact transport sector emissions output and vehicle safety for up to a decade after the initial acquisition.

A*f*MA is a knowledge-based organisation tasked with developing the professional status of fleet management through gathering and disseminating knowledge and information from around the world in the promotion of best practice in the management of fleets.

As such A*f*MA does not sell products or services to its members or the industry in general and therefore has no vested interest other than ensuring the adoption of effective and efficient outcomes for the fleet and automotive industry.

Executive Summary

While the Association supported a Fringe Benefit Tax (FBT) fixed percentage rate it is disappointed that Government chose the opportunity to burden the industry with an additional $2.4 billion tax when the 20% approach is fully implemented. A*f*MA's suggestion was for the Government to select the percentage that was revenue neutral. We believe this to be in the region of 11%, the figure proffered by Dr Henry in his report based on data from an ATO survey of 200 organisations.

According to Dr Ken Henry a 15% rate would deliver an additional $1.7 billion and the chosen 20% rate an additional $2.4 billion per year.

A*f*MA is of the view that FBT in its current form is inefficient, inequitable and has the ability to distort the behaviour of the market as outlined under 'unintended consequences' in the detailed submission below.

We contend that this change to FBT has been driven from a narrow perspective and a lack of appreciation/understanding of the issue. Most of the discussion prior to this change was directed at the perceived regard of vehicles acquired via a 'novated lease'.

It should be not be forgotten that FBT is a company tax and not normally an employee tax. It becomes an employee liability when a novated lease is involved and the lease is financed by the individuals' pre-tax dollars. It is the Association's view that novated lease/salary sacrifice vehicles are a small percentage of company supplied purchases (Table 1) and if Government identified a concern then it should be directed at this segment rather than the whole company vehicle market.

The Dr Henry review clearly shows that vehicles are over-burdened with high and inefficient taxes. Adding to this an extra $2.4 billion weight from the 20% FBT levy will not help. A*f*MA is of the view that this burden is likely to initiate a structural change in the supply of company provided vehicles which are available for private use.

In addition, of the ten FBT categories identified by Dr Henry the vehicle is singled out for special treatment. The other nine categories were recommended to move to a 'proposed valuation framework' based on 'market value'. The only category singled out for a different treatment is that of 'car benefit' which remains taxed at the original vehicle purchase price.

The Federal Government has stated that it wants a healthy automotive manufacturing sector with a future in hybrid and all electric vehicles. Hybrids and electric vehicles already suffer from a range of financial and operational concerns without having a 20% surcharge if the company owned vehicle is ever available for private use. In our view a 20% FBT rate will severely restrict the market for these vehicles; see table 2. A positive function of fleet is that it is the major source of vehicles into the used, second hand vehicle market. The quality and inclusion of advanced technology present in fleet vehicles will transcend into the used vehicle market to the benefit of the community.

Further inequities exist in the application of FBT via the transitional arrangements, in particular Example 5.8. Where a change in ownership of an organisation occurs any existing novated lease arrangements are carried over automatically and are subject to the new 20% rule. This means that the individual is penalised for something that is completely outside their control.

The Association also has a real concern that the increased financial burden on company supplied vehicles is likely to initiate a rise in grey fleet vehicles. Where this has occurred in other jurisdictions such as the UK the rise in 'Grey Fleet' vehicles, personally owned vehicles used for business, has given rise to serious issues of OH&S and the organisations ability to manage risk and meet its duty of care responsibility.

Detailed submission

Over 50% of yearly new vehicle sales are to fleet and commercial fleets. Purchasing decisions made by fleet today will impact the transport sector emissions output and vehicle safety for up to a decade after the initial vehicle acquisition.

It is A*f*MA's contention that FBT has become a substantial barrier to the provision of conventional internal combustion engine company vehicles and more importantly the adoption of Hybrid, all electric vehicles (EV). Such taxes as FBT and stamp duty are both inefficient and severely punish organisations financially for adopting safety features and new technology.

This latest increase in FBT has the capacity to have profound consequences to the management of fleets. A*f*MA is of the view that these financial imposts have now reached a level where they are likely to fundamentally change the way organisations acquire vehicles.

In reality a company fleet consists of several distinct vehicle groupings. There are 'tool of trade' vehicles which are those required by the company to perform its business. Secondly there are vehicles provided as part of the employees' conditions of employment package. Thirdly there can be a group of vehicles that are leased via a 'Novated' contract.

Novated lease arrangements, a three way agreement between an employer, employee and a vehicle supplier, are usually structured under Salary Packaging/Salary Sacrifice arrangements. Salary Packaging/Salary Sacrifice arrangements are not leases or methods of ownership they are simply financial instruments, a method of payment usually using pre-tax dollars.

The vehicle owner is the employee and by paying lease costs in pre-tax dollars it is deemed to be subject to FBT by the ATO. The FBT payment is the responsibility of the employee who also holds the vehicle residual risk.

As expressed by the Association in several other submissions to government there is an urgent need to reconcile the conflicting objectives between Federal and State Government taxation policy and adoption of new technology in vehicle safety and the early adoption of electric hybrid and all electric vehicles.

Fleets are an integral part of an organisation's business model and have a defined cost. A fleet manager must balance the relationship between the cost of ownership the vehicle and the benefit it provides to the organisation.

Bas is for change to FBT

Much of the debate on FBT has concentrated on 'Novated Lease' arrangements which in reality are not company vehicles. Our data on novated vehicles, derived from our yearly member survey, puts novated arrangements in the last five years at less than 10% of the total number of fleet vehicles surveyed.

Table 1: Percentage of total fleet acquisitions financed by Novated Lease

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Percentage	8%	8%	8%	14%	9%	11%	3%	4%	3.8%	4.3%	9.6%

Source AfMA Members Surveys 2001 - 2012

From our data it would appear that government has revised the FBT rate on concerns that a portion of novated lease holders were reportedly driving additional kilometres to reduce their personal tax rate. If this group, which is an easily identifiable sector of the market, were of concern to the ATO then any change should have been directed solely at this group, the novated lease segment, and not at the company vehicle market as a whole.

Rationale for the choice of 20% FBT rate

Why the rate of 20% was chosen is difficult to understand. Dr Henry in his review identified a revenue neutral rate of 11% average based on data from an ATO survey of 200 organisations. This follows closely with A*f*MA's indication from feedback from a small sample of members of the Association.

Dr Henry in his review concluded that a rate of 15% would increase the FBT take by $1.7billion per year. At 20% the yearly take would increase to $2.4billion. The Association can find no justification for a 20% FBT rate.

Application of inequities

The current FBT system contains many inequities, particularly in relation to motor vehicles. First and foremost it is levied at the top marginal tax rate of 46.5% regardless of the individual's actual tax rate.

The use of the top marginal approach is not the only element we have issue with. Most Fleet Managers are aware that the biggest single fleet cost is depreciation. However FBT totally dismisses the fact that a one, two or three year old vehicle does not have the same value as a new model.

Reality for the Fleet Manager is that most new vehicles lose in excess of 50% of their market value in the first three years. That means that after three years a $30,000 vehicle has a value of less than $15,000 yet it is taxed at $30,000 for a minimum of five FBT periods (years).

In the fifth FBT period a 30%, one off, reduction for FBT purposes is allowed. This equates to a taxable value of $20,000 for a vehicle that has a market value of less than $10,000.

The adoption of new technology and cultural change practice is predisposed by the value of the incentive involved and the nature and size of the disincentives associated with its adoption. A*f*MA considers that it is unsustainable that initiatives to reduce road trauma and emissions via the adoption of new technology are subject to a tax system that indirectly, yet severely, punishes organisations financially for such actions.

Transitional Arrangements

The proposed transitional arrangements also give rise for concern. Section 5.34 states that "The general intent of the transitional arrangements is to leave employers/employees who have pre-existing commitments (that is, those who have made financially binding decisions, in relation to a particular car, based on the old rules) under the old arrangements".

However, parts of the transitional arrangements examples run counter to this general intent. Example 5.8 "Anna works for X Co, and enters into a novated lease arrangement with her employer in January 2010. The lease runs until January 2013. The car fringe benefit is valued under the statutory formula method".

"On 12 November 2011, Y Co. officially takes over X Co, and Anna is now an employee of Y Co. From 12 November 2011, any car benefits provided to Anna will come under the new arrangements".

Under this scenario the employee will be disadvantaged through action totally beyond their control.

Involuntary acts that affect the employee such as a forced redundancy should not, in A*f*MA's view, be deemed as a change in contract conditions necessitating a change in the applicable FBT rate.

FBT as a disincentive

A*f*MA appreciates the difficulty posed by the objectives of the valid taxation of fringe benefits and the need to avoid impact on business efficiency, adoption of safety technology and emission reduction initiatives.

The dilemma for the Fleet Manager is that the current FBT system produces financial disincentives for the inclusion of enhanced safety and/or environmental initiatives into fleet operations. For example, should a Fleet Manager purchase a LPG or diesel engine it is likely to incur additional costs upwards of $2,000.

This additional $2,000 is subject to stamp duty and FBT resulting in an additional taxation bill to the organisation as illustrated in table 2. Across 100 vehicles and 4 years this results in an additional $153,614 in FBT cost alone.

Table 2- FBT as a disincentive

Vehicle motive force type	Cost of vehicle	FBT	Gross-up factor	Tax rate at 46.5%	Fleet size	Vehicle retention	#Initial Cost x 100 vehicles	FBT cost	Total ownership cost
	1	2	3	4	5	6	8	7	9
Internal Combustion	$20,000	20%	2.0647	46.5%	100	4yrs	$2,000,000	$1,536,137	$3,536,137
With Safety Package	$22,000*	20%	2.0647	46.5%	100	4yrs	$2,200,000	$1,689,751	$3,889,751
Hybrid	$40,000	20%	2.0647	46.5%	100	4yrs	$4,000,000	$3,072,274	$7,072,274
All Electric	$60,000	20%	2.0647	46.5%	100	4yrs	$6,000,000	$4,608,410	$10,608,410

*Internal combustion vehicle + cost ($2,000) for a typical safety package upgrade
#Provision for a vehicle residual value in not included. There is some difficulty as there is no EV residual history.

Vehicles with enhanced safety and/or reduced emissions features should be more financially attractive to fleets not less. There is an urgent need to reconcile the legislative conflicts that produce disincentives to allow fleets to be at the forefront of a robust movement to substantially increase the number and range of safer and more environmentally friendly vehicles in the fleet.

The reality is that FBT serves as a burden to the effective management of fleets. Table 1 provides a comparison of the effect of FBT on vehicle of comparative size with differing technological drive trains. Also the inclusion of a simple safety option of $2,000 has a dramatic impact on the FBT cost (Table 2).

At a basic level the adoption of new technology is predisposed to two sets of influences; the incentive and/or the disincentive. A sought-after outcome can be achieved without the need to provide an incentive. More importantly however, the removal of disincentives, such as those that currently negatively influence purchase decisions, is necessary to positively influence change.

The Association is of the opinion that this issue has now developed into a strain of such magnitude that we are likely to see the way vehicles are provided to structurally change.

Unintended consequences

Events can give rise and lead to the development of 'unintended consequences', outcome that was not intended or planned. It is the Associations view, based on feedback from several of our members, that such an unintended consequence is already underway and it is our expectation that it will gather pace within the next 6 to 18 months.

The convergence of two events, the current changes to FBT and the introduction of new international accounting rules will accelerate structural changes in the way that organisations deal with new 'tool of trade' vehicles.

As we understand it the proposed new international accounting rule will require all lease commitments to be shown on the organisations balance sheet. For assets to be off balance sheet was one of the main reasons for the increase in shift from ownership to leasing a number of years ago.

The coming together of these two events presents organisations with two main choices, bring the value of its fleet vehicles on to the balance sheet or disinvest itself of these vehicles.

Disinvestment offers the best outcome for the organisation as it offers a number of benefits. It gets the vehicles off the balance sheet, removes any FBT liability (FBT is a company tax except in novated lease circumstances) as well as the residual value (depreciation) risk.

This can be simply achieved by substituting the provision of a vehicle with a monetary payment. The day to day management tasks of the vehicle is transferred to the employee. When used on company business they form part of the company's 'grey fleet'. There is a mistaken belief in many organisations that outsourcing transport tasks to privately owned vehicles also out sources the responsibility for the management of risk. The downside is that employees are likely to purchase used vehicles using criteria based purely on cost rather than safety or sustainability.

There is some certainty that our projection will come to fruition as it provides a large financial saving opportunity for organisations. Anecdotal feedback from several A*f*MA members indicates that this transition is already underway.

In Summary

To remove the inherent disincentives of the current FBT system A*f*MA recommends the adoption of the following:-

Reduce the FBT rate to the revenue neutral percentage position although his may not be enough to stop the transition away from company supplied vehicles.

Have a nominal reduction in the FBT value of the vehicle (the base for calculating FBT liability) so as not to discourage the adoption or inclusion of environmental and safety equipment features.

A tax reduction for organisations adopting safety or emission reducing technology similar to the USA FET Incentives for Idling Reduction Units and Insulation or the proposed Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008, see attachment 1.

We see the above as addressing a number of negative issues associated with FBT. It does not discourage the uptake of safety features/standards in vehicles and therefore reduces road trauma and it does not discourage the uptake of more sustainable vehicles.

FBT has become a multi-level economic disincentive and a burden to the effective management of fleets. As organisations seek to enhance safety, reduce emissions and/or costs the fleet becomes problematic as any increase in vehicle cost translates into a higher tax bill; FBT and stamp duty. FBT in particular has, in reality, become a burden to the effective management of safer and more sustainable fleets.

Attachment 1

Commercial Motor Vehicle Advanced Safety Technology Tax Act of 2008 (Introduced in Senate)

S 3428 IS

110th CONGRESS

2d Session

S. 3428

To amend the Internal Revenue Code of 1986 to provide a credit against income tax to facilitate the accelerated development and deployment of advanced safety systems for commercial motor vehicles.

IN THE SENATE OF THE UNITED STATES August 1, 2008

Ms. STABENOW (for herself, Mr. VOINOVICH, and Mrs. DOLE) introduced the following bill; which was read twice and referred to the Committee on Finance

Extract

SEC. 45Q.

CREDIT FOR COMMERCIAL VEHICLE ADVANCED SAFETY SYSTEMS.

(a) Allowance of Credit- For purposes of section 38, the commercial vehicle advanced safety system credit determined under this section is an amount equal to 50 percent of the cost of any qualified commercial vehicle advanced safety system placed in service by the taxpayer during the taxable year.

(b) Limitations-
  - (1) PER SYSTEM- The credit allowable under subsection (a) for each qualified commercial vehicle advanced safety system shall not exceed $1,500.
  - (2) PER VEHICLE- The credit allowable under subsection (a) with respect to property for each qualified commercial vehicle shall not exceed--
    - (A) $3,500, reduced by
    - (B) the aggregate amount of credit allowed to the taxpayer under this section with respect to such vehicle for all prior taxable years.
  - (3) PER TAXPAYER- The credit allowable under subsection (a) to the taxpayer for the taxable year shall not exceed $350,000.

(c) Qualified Commercial Vehicle Advanced Safety System- For purposes of this section, the term `qualified commercial vehicle advanced safety system' means any property which is part of a system installed on a qualified commercial vehicle if--
  - (1) (A) such system is a brake stroke monitoring system, lane departure warning system, collision warning system, or vehicle stability system, or

    (B) such system is specifically identified by the Administrator of the Federal Motor Carrier Safety Administration or the Administrator of the National Highway Traffic Safety Administration for the purposes of this paragraph as significantly enhancing the safety or security of the driver, vehicle, passengers, or load of a qualified commercial vehicle and such identification is in effect as of the date such system is placed in service by the taxpayer,
  - (2) such system is certified by the manufacturer of such system (before such vehicle is first used by the taxpayer for its intended purpose after installation of such system)--
    - (A) to be appropriate for the make, type, and model of the qualified commercial vehicle on which it is to be installed, and
    - (B) to function as designed if installed properly,
  - (3) in the case of a system which is not installed by the manufacturer of the qualified commercial vehicle or by an installer authorized by the manufacturer of such system, such system is certified by the installer of such system to be properly installed and functioning on the vehicle before such vehicle is first used by the taxpayer for its intended purpose after installation of such system,
  - (4) the original use of such system begins with the taxpayer, and
  - (5) depreciation (or amortization in lieu of depreciation) is allowable with respect to such system.