

**AUSTRALIAN
AUTOMOBILE
ASSOCIATION**

**Constituent
Members**



7 July 2008

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

Inquiry into the Luxury Car Tax

I am writing in submission to the Standing Committee on Economics Inquiry into the Luxury Car Tax (LCT) Amendment Bills.

The Australian Automobile Association (AAA) serves as the federal secretariat of the motoring clubs in each State and Territory. Through these organisations, AAA represents the interests of more than 6 million motorists and, indirectly, all Australian motorists at the national and international levels. As such, we have a keen interest in factors that impact on the cost of motoring. We therefore welcome the opportunity to make this submission to the Committee.

AAA recently set out its views on the Luxury Car Tax (LCT), and the proposal to increase the LCT rate, in a submission to the Review of the Automotive Industry (available at http://www.aaa.asn.au/documents/reports/2008/Review_of_Auto_Industry.pdf.)

I have attached an extract from that submission which deals with the LCT for your consideration.

In short, for reasons of safety, environmental performance, the failure of the threshold to keep pace with movements in car prices and quality and the desirability for consistency in the application of a common rate of 10 per cent GST to all goods and services, we recommend that the LCT be abolished.

Should you wish to discuss this submission further, please don't hesitate to contact me

Yours sincerely,

Mike Harris
Executive Director

GPO Box 1555
216 Northbourne Ave
Canberra ACT 2601
Ph: (02) 6247 7311
Fax: (02) 6257 5320
Email: aaa@aaa.asn.au
ABN 25008 526 369
Web: www.aaa.asn.au

Extract from the Australian Automobile
Association Submission to the Review of
the Automotive Industry, May 2008

6 Luxury Car Tax

Apart from tariffs, a Luxury Car Tax (LCT) assists the local industry as it applies mainly to imported vehicles. The LCT applies to the purchase of so-called luxury vehicles. It is a tax of 33 per cent (increased from 25 per cent in the Federal Budget on 13 May 2008) levied on the GST-exclusive value of cars priced above \$57,123. The LCT is projected to generate almost \$3 billion in revenue between 2007-08 and 2011-12.

It is disappointing that the Government Budget announcement in May 2008 pre-empted the outcomes of this Review. It also pre-empts the comprehensive review of the taxation system that was formally announced in May 2008.

The actual LCT threshold is indexed to the CPI motor vehicle index and because that index has generally declined over recent years, there has been only one very marginal increase in the threshold since 2002-03. On the current formula there will be no increase for 2008-09.

The LCT is really a remnant of the old tax system when luxury items such as jewellery, furs, watches, clocks, cameras, tape recorders, video recorders, televisions and radios were taxed at higher rates of sales tax. These items were described as luxuries or non-essential. The GST was intended to remove such anomalies in the tax system by applying uniform rates of tax across all goods and services.

Just as the differential tariff on PMVs and 4WDs creates distortions in the market, so does the LCT, particularly in terms of creating a disincentive to motorists wanting to purchase so-called luxury vehicles, which are often relatively safe and environmentally-friendly

In a recent media release BMW states:

...luxury brands are today at the forefront of engineering cleaner cars which emit less CO₂ emissions. For example, the BMW 530i [which is subject to LCT] emits nearly 20 per cent less CO₂ than an equivalently sized and powered Holden Calais V [which is not subject to LCT].

It is also worth noting that the winner of the Australian Automobile clubs' Australia's Best Cars (ABC) award in the Luxury category was the Lexus GS450h — a petrol/electric hybrid car with a fuel consumption of 7.9L/100 and with a 5 star safety rating under the Australasian New Car Assessment Program (ANCAP). The LCT on this environmentally-friendly luxury vehicle will rise by around \$5,000 as a result of the Budget increase in the LCT rate.

¹ AAP NewsWire, Media Release, BMW Group Australia, Sunday 11 May 2008

On the safety front, the difference between vehicles is often stark. For example, the BMW 323i (\$65,000) has the following features as standard: driver and front passenger airbags (including occupant detector); front side airbags; head airbag for front and rear. This combination of features will not be available as standard in the similar sized, soon to be released FG Ford Falcon (we note that the current XT Falcon is priced at \$34,990).

We mention side head airbags in particular because research from the USA indicates that this technology can reduce the risk of death in a side impact crash by up to 40 per cent.²

Although there is a significant price difference between these two vehicles — and it should be noted that the Ford has a driver and front passenger airbags — the question which needs to be asked is why should buyers be penalised by a LCT for purchasing a safer vehicle?

Another example of the fact that vehicles are safer at the higher-priced and luxury end of the market can be seen in the analysis of ANCAP star ratings in three particular categories of vehicle in the ABC awards.

- In the Luxury Car category, all 11 vehicles tested had electronic stability control (ESC) and curtain airbags (CA).
- In the Mid-size Car over \$28,000 category, 15 out of 22 cars tested had these two features.
- In the Small Car category, 16 cars were tested and none of them had these features.

Another distortion arising from the LCT is that some manufacturers might price their vehicles at just below the threshold, but remove safety and other features which may otherwise have been included. For example, extra airbags, or a more sophisticated engine, may not be included because they would add to the cost of the vehicle. This is not in the motorists' (or the community's) best interests.

6.1 Luxury Car Tax Threshold

If a decision is taken by the Government to retain the LCT, then the threshold should be adjusted upwards. The impact of the LCT has been compounded by the threshold failing to keep pace with the movements in actual car prices.

Indexation of the LCT threshold is based upon the ABS consumer price index, motor vehicle index (CPIMV). However, because price movements are adjusted for 'quality' changes in the calculation of the CPI, the CPIMV effectively only measures the change in price of a 'static car' — that is a car which does not change in size, specifications and other quality attributes over time.

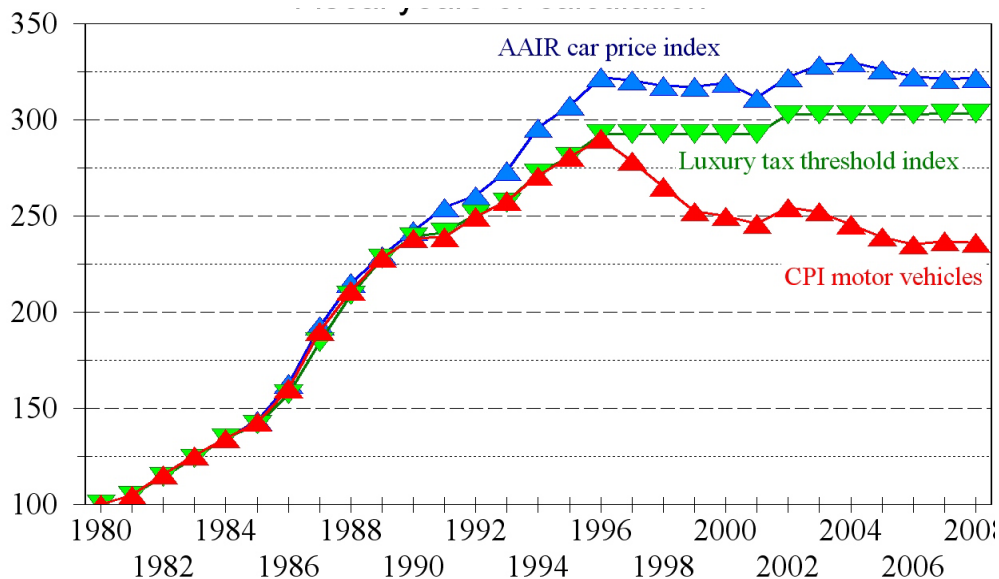
² <http://www.arrivealive.vic.gov.au/node/146>

Consequently, the significant improvements in car ‘quality’ over recent decades have not been reflected in the LCT threshold, because the CPIMV discounts price changes for these ‘quality’ changes.

Figure 1 gives some insight into how the CPIMV and thus the LCT threshold have lagged the movement in car prices. It shows movements in the following three series based on indexes with 1979-80 = 100:

- the CPIMV;
- the movement in the index which determines the LCT threshold for the following year; and
- the Automotive Industry Authority/Australian Automotive Intelligence Report car price index, commencing from the 1984 fiscal year (and set at the same index value for the CPIMV in that year).

Figure 1 Car price and luxury threshold indexes



Source: Australian Automotive Intelligence

The comparison of the three series shows that since the AIA/AAIR index — which is based upon the recommended retail prices (RRP) of cars — has been available, it has increased more rapidly than the CPIMV and thus the LCT threshold, especially between 1990 and 1997. The reason for the disparity between the AIA/AAIR index and the CPIMV is due to the fact that the former captures quality improvements in vehicles, whereas the latter discounts them.

Except for short term variations in vehicle discounting, the large gap that has evolved between the AIA/AAIR index and the CPIMV since 1997 has been because car prices have been relatively stable and quality has improved. The net effect of this is that the LCT threshold has increased only twice in the last decade and then only very marginally in 2007-08 and is not expected to rise in 2008-09.

Another insight into the movement of car prices relative to the LCT threshold is shown in Table 2 which compares movements in actual prices of the Ford Falcon GL, Forte and XT sedans from 1979-80 to 2007-08 with the luxury threshold at the time. It shows that over time, the price of the Ford has moved closer to the LCT threshold.

Table 2 Comparison of Ford Falcon price with luxury threshold

Fiscal year	1979-80	1989-90	1999-00	2007-08
Ford Falcon price (\$)	7974	22926	30690	35990
Luxury threshold (\$)	18000	42901	55134	57123
Percent of threshold	44.3	53.4	55.7	63.0

Source: Glass's Guide, various issues; Falcon prices at end December

Table 3 gives some insight into the movements of luxury car prices over the last 6 years — essentially the period since the last significant adjustment occurred to the luxury tax threshold. The Table includes the best selling models above the luxury tax threshold in 2007 and the closest comparable variants have been chosen for each model in 2002 and 2008.

Except for the Lexus models, where there has been some significant restructuring of the range of variants available for both the IS and GS models and therefore two very disparate price movements, the prices of all the models have risen over the period, and not fallen in recent years as the AAIR index for all cars has. This reinforces the point that threshold has failed to keep pace with car prices.

It is worth noting that the United States abolished its luxury car tax in 2003. From January 1997, the tax was applied to cars costing more than US\$36,000 (except electric vehicles) and the tax rate was lowered from 10 percent to 8 per cent. The rate was progressively lowered by one percentage point each year until 2003.

For the reasons of safety, environmental performance, the failure of the threshold to keep pace with movements in car prices and quality and the desirability for consistency in the application of a common rate of 10 per cent GST to all goods and services, we make the following recommendation

Recommendation 2

AAA recommends that the Luxury Car Tax be abolished.

Table 3 Medium and large cars above the luxury tax threshold

Model	Key specifications	Price May 2002	Price May 2008
BMW 325i sedan	2.5 6, 5/6 speed auto	\$70700	\$73800
Lexus IS Luxury sedan	2.0/2.5 6, 4/6 speed auto	\$59690	\$70474
Mercedes-Benz C240/280 sedan	2.6/3.0 V6, 5/7 speed auto; Elegance variants	\$79500	\$86000
Audi A4 sedan	3.0/3.2 V6, 5/6 speed auto	\$80,500	\$88500
BMW 530i Executive sedan	3.0 6, 5/6 speed auto	\$99800	\$113500
Mercedes-Benz E 240/280 sedan	2.4/3.0 V6, 5/7 speed auto; Elegance variants	\$96180	\$101500
Audi A6 sedan	2.4/2.8 V6, CVT	\$79980	\$84990
Lexus GS 300	3.0 6, 5/6 speed auto	\$106050	\$96900

Source: Glass's Guide Autocomplete, May 2002 and May 2008