

Tax Research Seminars Online



THE UNIVERSITY OF
MELBOURNE

2021

Melbourne Law School

A Review of the Luxury Car Tax

Dr Kathryn James

Senior Research Fellow, Monash University

Date : **28 October 2021**

Time : 3.30 – 5.00pm

Via zoom

Schedule for 2021 Tax Research Seminars Online

1. **25 February 2021**, A new-knowledge approach to corporate income tax efficiency – Associate Professor Mark Bowler-Smith (Deakin University), discussant Professor John Freebairn (University of Melbourne)
2. **25 March 2021**, The Law and Policy of VAT Tourist Tax Refund Schemes: A Comparative Analysis – Associate Professor Tingting Wang (University of Melbourne/ Southwest University of Political Science and Law, China) and Professor Miranda Stewart (University of Melbourne), discussant Mr Michael Evans (University of Melbourne)
3. **29 April 2021**, MLSTRSO-Special Edition: *Rebellion, Rascals, and Revenue*. A discussion with Joel Slemrod (University of Michigan) and Mike Keen (Deputy Director of the Fiscal Affairs Department at the International Monetary Fund) on their new book, [*Rebellion, Rascals, and Revenue*](#) (Princeton Press, 2021)
4. **27 May 2021**, History of Tax Reform in Australia. – Mr Paul Tilley (University of Melbourne/ ANU TTPI), discussant Mr Greg Smith (Former Head of Treasury Budget and Revenue Groups)
5. **29 July 2021**, Tax law as political gesture: 2017 US Tax Cuts and Job Act through the lens of political anthropology – Ms Viva Hammer (Melbourne Law School, Visiting Fellow), discussant Associate Professor Lael Weis (Melbourne Law School)
6. **18 August 2021**, The effectiveness of voluntary corporate tax disclosures: an Australian case study - Dr Bronwyn McCredie (QUT), discussant Dr Rodney Brown (University of New South Wales)
7. **30 September 2021**, Taxation of the Commercialised Body – Mr Micah Burch (University of Sydney), discussant Professor Julie Cassidy (University of Auckland)
8. **28 October 2021**, A Review of the Luxury Car Tax – Dr Kathryn James (Monash University), discussant Dr Troy Henderson (University of Sydney)
9. **25 November 2021**, Excess Profit Tax – Professor Emeritus John Taylor (UNSW)

A REVIEW OF THE LUXURY CAR TAX

Kathryn James*

Abstract

The luxury car tax (LCT) is the only sales tax in Australia that applies to the sale of items designated as luxury. The LCT was introduced as part of the A New Tax System package of reforms that introduced the Goods and Services Tax to prevent the politically unpalatable sight of the sales tax on luxury cars falling from 45 per cent under the previous wholesale sales tax to 10 percent under the GST. Recent calls to remove the luxury car tax proceed on the basis that the tax is an anachronism without justification that should be abolished. This article takes a broader view to ask what are the merits in applying a selective single-stage sales tax to a specific item of consumption – that of luxury cars. It examines the economic and normative justifications for, and criticisms of, such a tax. The analysis gives rise to a weak conclusion and a strong one. The weak conclusion is that far from there being *no* normative justification for the tax, there is an obvious revenue-raising and redistributive justification. The strong conclusion is that there is a *prima facie* case to be made in both efficiency and justice for maintaining the LCT and even for extending such a tax to other luxury items when feasible to do so.

1 Introduction

Australians purchase around 1 million new motor vehicles each year with around 100,000 of these being luxury cars.¹ The luxury car tax (LCT) is a single-stage sales tax that is generally imposed on the sale or importation of eligible luxury motor vehicles whether they be sold to final consumers or to businesses.² The tax is levied in addition to but not inclusive of Australia's primary sales tax, the goods and services tax (GST). The GST is generally levied on all eligible supplies throughout the production and distribution chain at a flat rate of 10 percent (unless supplies are GST-free or exempt), but it targets final expenditure on consumption

* Australian Research Council, Discovery Early Career Research Fellow, Monash University, Australia. This research was partially supported by the and by the Monash Law Faculty and by the Australian Government through the Australian Research Council's Discovery Projects funding scheme (project DE190100346). The views expressed herein are those of the author and are not necessarily those of the Australian Government or Australian Research Council. My thanks to Peter Mellor and Adam Reisner for their excellent research assistance and to Patrick Emerton. All errors are my own. This paper is a work in progress and thus in draft form only.

¹ Australian National Audit Office, *ANAO Audit Report No.45 2010–11: Administration of the Luxury Car Tax* (2011) 11 [1] 'ANAO Report'; see part 4.1 of this paper.

² There is a limited rebate schemes for primary producers and tourism operators and the system of quoting can defer payment of the LCT until a sale to a final consumer, see below 4.4: *A New Tax System (Luxury Car Tax) Act 1999*, div 9.

by virtue of a refund mechanism which enables registered suppliers (such as a business) to claim a refund, but not final consumers.

The luxury car tax (LCT) is the only sales tax in Australia that applies to the sales of items designated as luxury. Whereas the personal income tax is traditionally levied on a progressive base (with marginal tax rates increasing as income rises), the flat-rate GST is generally regressive in effect – placing a higher relative burden on the poor (who spend all their income) than the rich (who both consume and save).³

Prior to the introduction of the GST in 2000, Australia imposed the Wholesale Sales Tax (WST) which operated under a system of graduated rates determined by the classification of goods into various schedules including higher rates for luxury or non-essential items. The list of luxury items varied over the years but specifically included motor vehicles based on price from 1986. The LCT was introduced as part of the A New Tax System package of reforms that introduced the GST to prevent the politically unpalatable sight of the sales tax on luxury cars falling from 45 per cent under the previous wholesale sales tax to 10 percent under the GST.

Recent calls to remove the luxury car tax proceed on the basis that, more than twenty years on, the tax is an anachronism without justification that should be abolished. This paper therefore asks – whether there is any justification for the LCT? Or to frame the question more broadly – is there a role to play for the application of select excise taxes to specific items of luxury consumption such as luxury cars?

Part 2 of this paper details the calls to repeal the LCT and Parts 3-6 respond to the main criticisms that support for call for repeal: first, that the LCT is an anachronism that has outlived its original intent; second, that the LCT is inefficient being levied on too narrow a base at too great a cost; and third, that the LCT is unfair because it arbitrarily taxes or penalises people of equivalent economic capacity based in their tastes.

The analysis gives rise to both a weak and a strong conclusion. The weak conclusion is that it is not true to say that the LCT has *no* merit. Consistent with its historic and contemporary application, the LCT has an obvious but small role to play in revenue generation (including as a supplement to the income tax) and redistribution. The paper finds that although the LCT generates a small amount of revenue it does so at an appropriately low level of administrative and compliance costs because the LCT is in essence administered as part of the overall GST/business tax system. Although there are some areas for improvement, these can be addressed within the design of the tax itself and do not warrant its repeal. The strong conclusion is that, there

³ For a summary of the arguments see, eg, Kathryn James, *The Rise of the Value-Added Tax* (CUP, 2015) 32-35.

is a prima facie case to be made based in both efficiency and justice for maintaining the LCT and even for extending such a tax to other luxury items such as luxury yachts and private jets if feasible to do so.

Before proceeding further, it is important to recognise two limitations. First, this paper focuses primarily on the economic and distributional impact of the LCT rather than broader considerations such as environmental concerns (which are addressed in passing). Second, the LCT and the GST are but two of a number of taxes and charges that apply to motor vehicles. Others include state-based compulsory annual vehicle registration schemes and transfer of ownership taxes (stamp duties) (some of which impose a progressively higher rate based on the value of the vehicle)⁴ as well various fuel excises and import tariffs levied by the Commonwealth.⁵ In addition, the income tax and specifically the fringe benefits tax affect the treatment of motor vehicles including luxury motor vehicles (being either income in kind and taxed under the FBT or a depreciable business expense for which deductions can be claimed). Although, the interaction of the LCT and GST with these other taxes is essential to understanding the overall tax treatment of luxury motor vehicles, the specific focus of this paper is on the merits or otherwise of a dedicated sales tax on luxury cars (and other items of luxury expenditure).⁶

2 The calls to repeal the LCT

A review of the discussion in Australia of the luxury car tax might lead the reader to conclude that, the tax has no merit – economic or otherwise – other than as a means to generate a paltry amount of revenue.⁷

A survey of media reports from 1998-2021 for this paper found that the volume of articles written on the LCT has significantly increased since its introduction as has opposition towards it.⁸ These media reports and commentary are mostly dominated by car industry representatives who since 2008 (when the LCT rate

⁴ Victoria has progressive rates of stamp duty payable on value including higher rates for luxury (AUD 100,001-150,000) and super-luxury vehicles (more than AUD 150,000) effective from July 2019, Queensland introduced a similar measure in 2018: State Revenue Office (Victoria), 'Motor vehicle duty current rates' (1 July 2021) <<https://www.sro.vic.gov.au/motor-vehicle-duty-current-rates>>; Joshua Dowling, 'Peak car dealer body plans High Court challenge over new stamp duties' *Brisbane times* (16 June 2019)(online).

⁵ Australia imposes a 5% tax on vehicles imported from jurisdictions with whom there is no free-trade agreement: *Customs (Tariff) Act 1995* (Cth), Schedule 3, ch 87 (item 8703).

⁶ Prafula Pearce and Dale Pinto, 'An Evaluation of the case for a congestion tax in Australia' (2015) *The Tax Specialist* 146, 151; Standing Committee on Economics, Commonwealth Parliament of Australia Senate, *Tax Laws Amendment (Luxury Car Tax) Bill 2008* (August 2008) 23.

⁷ See eg Tony Weber chief executive of the Federal Chamber of Automotive Industries concludes that the 'only thing that the luxury car tax does is create revenue for the government': Darren Gray, European Car Makers Rev Up Push Against Luxury Car Tax', *Sydney Morning Herald* (11 October 2019)(online).

⁸ Approximately 5,000 articles appeared in a key word search for "luxury car tax" on Factiva. From 1998-2007, there was an average of 44 articles per year, in 2008 there were 1,557 articles (coinciding with the increase in the LCT rate from 25-33% and the Henry Review), from 2009 to date there has been on average 230 articles per year. Over this time the opposition towards the LCT has increased. A random sample of 49 articles from the years 1998-2009 found that just over half (28) were critical of the LCT, 14 were balanced or neutral and 7 that were broadly supportive. From 2010-2021, a random sample of 52 articles found 46 critical articles critical of the tax, 4 articles that were neutral and only two in support.

increased) have intensified a concerted campaign to repeal the LCT.⁹ Commentators and industry representatives have variously described the tax as “unconscionable”¹⁰, “outdated, unjustifiable and unnecessary”.¹¹ A review of the academic literature reveals that very little attention has been paid to the LCT with very few analyses favourably disposed to it.¹² Two major tax reviews have expressed misgivings about the tax with the most prominent, the Henry Review, recommending its abolition in 2009.¹³ The most vigorous defence of the LCT has (reluctantly) come from elected officials who, when forced to defend calls to repeal the tax, express a desire to retain the tax primarily for revenue-raising purposes even while expressing misgivings about its operation. As the Labor leader, Anthony Albanese declared: "If it's a choice between someone who is buying a car for a couple of hundred grand pays a bit of tax, or whether that money is available for someone with dementia, I know where my priorities are".¹⁴

Chief among the criticisms is that the LCT has outlived its original intent to secure support for the controversial GST reforms.¹⁵ It was poor political optics to ask the poor to pay more (relative to the rich) by introducing the GST when the move away from the multi-rated WST to the GST would create a windfall gain to the rich on a prominent item of luxury consumption. The logic therefore follows that now that the GST is bedded down there is no longer any need to maintain this anachronism. Others contend that the LCT is a protectionist hangover from when Australia once boasted a domestic automotive-manufacturing industry which should

⁹ See, eg, Darren Gray, 'European Car Makers Rev Up Push Against Luxury Car Tax', *Sydney Morning Herald* (11 October 2019)(online); Nassim Khadem and Edmund Tadros, 'End tariffs and luxury car tax: industry', *Australian Financial Review*, 9; Toyota Australia, Media Release: Toyota Calls for Luxury Car Tax Abolition (21 June 2011); 'Luxury Car Tax Attacked' *The Cairns Post* (16 July 2011)(effectively reproducing significant portions of the Toyota media release); Joshua Dowling, 'Toyota drivers seeing red over tax', *The Age* (15 June 2019) 4; Fleur Anderson, 'Toyota on tax starting line', *The Australian Financial Review* (22 June 2011) 7; Andrew Tillet, 'Motor lobby calls for scrapping of 'redundant' car taxes', *AFR* (19 February 2020) 9; Joshua Dowling, 'Fresh call to pull brakes on tax', *The Sydney Morning Herald* (15 June 2019) 8.

¹⁰ Richard Dudley, chief executive of the Motor Trades Association of Australia: Patrick Commins, Richard Ferguson, 'Drop Car Tax, Treasurer Told', *The Australian*, 1

¹¹ Horst von Sanden, Mercedes-Benz Australia/Pacific quoted in: Darren Gray, 'European Car Makers Rev Up Push Against Luxury Car Tax', *Sydney Morning Herald* (11 October 2019)(online).

¹² See, eg, Andrew McPherson, Sharon Guffogg, Sae Takemoto & Scott Williams, (2011) 4(1) *Deakin Papers on International Business Economics* 17 (repeat the standard economic critique of the LCT as a dead weight loss but then find that it is has not dampened demand and does generate revenue but nevertheless conclude that the LCT is inefficient and distortive and call for its removal); Prafula Pearce, 'The luxury car tax: past its use-by date' (2011) 47 (11) *Taxation in Australia* 703; Prafula Pearce and Dale Pinto, 'An Evaluation of the case for a congestion tax in Australia' (2015) *The Tax Specialist* 146, 151.

¹³ Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), volume 2, 476 – 'Recommendation 80: The luxury car tax should be abolished'; Australian Treasury, *Re:Think: Tax Discussion Paper* (April 2015), 157, 162. See also a Senate Committee Report. A Senate Committee review of a Labor government proposal to increase the rate of the LCT from 25% to 33% was split along party lines: Standing Committee on Economics, Commonwealth Parliament of Australia Senate, *Tax Laws Amendment (Luxury Car Tax) Bill 2008* (August 2008).

¹⁴ Phillip Coorey, 'The politics of axing the luxury car tax' *AFR* 20 February 2020 (online) <https://www.afr.com/politics/federal/the-politics-of-axing-luxury-car-tax-20200219-p542fr>; Then Minister for Trade, Tourism and Investment, Simon Birmingham, declared in a radio interview in 2019 that, "we have the tax system that we have that's evolved over many decades and the luxury car tax has been in place for a very long period of time. All of these taxes are things that we love not to have but we have them so that we can pay for roads, schools, defence forces, hospitals, aged care, disability insurance schemes, all of those sorts of public services' Interview with Tom Elliot, Radio 3aw, 5 September 2019, <<https://www.trademinister.gov.au/minister/simon-birmingham/transcript/interview-3aw-drive-tom-elliott-0>>

¹⁵ See, eg, Darren Gray, 'European Car Makers Rev Up Push Against Luxury Car Tax', *Sydney Morning Herald* (11 October 2019)(online); Sid Maher, Andrew Fraser, Adam Creighton, 'Call to end tariffs to slash prices', *The Australian* (12 February 2014) 1.

follow the fate of that industry.¹⁶ Part 3 examines these claims by examining the LCT in historical and comparative context.

The most prominent case made against the LCT made by the Henry Review in 2009 whereupon the review was unequivocal in its assessment:¹⁷

Luxury taxes should not be used to raise revenue. They are inefficient because of their narrow base. Taxing luxury goods is also an ineffective and arbitrary means of redistributing economic resources. The luxury car tax should be abolished...

In the current Australian context, a tax on luxury cars is not a desirable means of raising revenue. It discriminates against a particular group of people because of their tastes. It is not an effective way of redistributing income from rich to poor. Its design is complex and becoming more complex over time.

The Review outlined three primary objections to the LCT. First, the tax is inefficient by design – as a select impost on a narrow base (of luxury cars) it generates minimal revenue at too great a cost.¹⁸ Second, the tax is inefficient in effect because it distorts market outcomes.¹⁹ Relatedly, the Review (and others) express concern on the social and environmental impact of the tax – for example, that the LCT is a deterrent to electric vehicles and to technological innovations (which inhere in luxury vehicles).²⁰ Third, the tax is unfair and discriminatory in its impact (targeting people of equal means based purely on their tastes) and failing to sufficiently redistribute resources from rich to poor (because of its narrow base and failure to target just the rich).²¹ These criticisms are addressed in turn in Parts 4-6 of the paper.

¹⁶ See, eg, Nassim Khadem and Edmund Tadros, 'End tariffs and luxury car tax: industry', *Australian Financial Review*, 9; Australian Taxpayers Alliance, Media Release: Luxury car tax failed to save Holden (19 February 2020); Patrick Commins, Richard Ferguson, 'Drop Car Tax, Treasurer Told', *The Australian*, 1

¹⁷ Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), 469, 476.

¹⁸ Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), 476.

¹⁹ Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), 469.

²⁰ The Henry Review notes that the use of a preferential threshold for environmentally friendly vehicles under the LCT 'is a costly and ineffective way of limiting greenhouse gas emissions' and advocate instead for an emissions trading scheme to address the issue: Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), 476. See further the Grattan Institute recently recommended suspending the LCT on electric vehicles until 2030 to facilitate their uptake by which time they recommend the government reconsider the LCT altogether: Tony Wood, Alison Reeve, James Ha, *Towards Net Zero: Practical Policies to Reduce Transport Emissions* (Grattan Institute, July 2021) 4, 19; Greg Brown, 'Coalition split over tax on electric cars', *The Australian* (14 April 2021) (online); ANAO Report (2011) 32 [1.29] – notes that motoring bodies regard the LCT as a deterrent for new energy-efficient cars; Andrew Tillet, 'Motor lobby calls for scrapping of 'redundant' car taxes', *AFR* (19 February 2020) 9; Senate Report (2008) 13, [2.45] 'Because safety and environmentally friendly technologies appear first as optional equipment, they usually appear on luxury vehicles first, but gradually diffuse to standard models.' However, the Committee notes that because such technology forms 'part of the core business for luxury car manufacturers' then 'they are unlikely to remove features from more than a small fraction of their models' and further notes that the Australian car market represents too small a segment of the global market (less than 2 percent) to affect research and development budgets: 13 [2.47], 12 [2.49].

²¹ Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (December 2009) ('Henry Review'), 475.

3 An anachronism? The LCT in historical and comparative perspective

Some historical and comparative context is useful to assess the claim that the LCT is either an anachronism or a protectionist hangover.

3.1 Historical context

Australia has had a general sales tax at the federal level since the Wholesale Sales Tax (WST) was first introduced in 1930 to fund the revenue needs of a fisc constrained by the severe economic contraction of the Great Depression.²² In addition to raising revenue, the WST was variously deployed as a regulatory tool of economic intervention. At times high rates were imposed on certain goods during wartime to discourage the redirection of scarce resources away from the war effort. At other times high rates were used as a tool to dampen or redirect consumer demand including to address trade deficits and inflation as well as a tool of redistribution.²³ This interventionist rationale was facilitated by the adoption of a graduated rate structure from 1941 with different categories of goods taxed at different rates set by different schedules according to different rationales. The highest tax rate contained what might be called a luxury rate (ranging upwards of 66% at times) which applied to a varying list of (non-essential) goods over the years including jewellery, furs, watches and beauty products.²⁴

From the outset, the WST applied to the sale of motor vehicles²⁵ and in keeping with the general deployment of the sales tax, the treatment of motor vehicles varied considerably over the decades motivated by differing

²² See *Sales Tax Assessment Act (No 1) 1930* (Cth) (enacted on 18 August 1930) and associated Acts.

²³ For an overview of the various historical iterations of the WST see: Julie Patricia Smith, 'The Changing Redistributive Role of Taxation in Australia Since Federation' (PhD Thesis, The Australian National University, 2002), ch 6. Smith disputes Commonwealth Treasury accounts which present the use of sales tax during wartime as motivated by a desire to direct resources to wartime efforts, arguing that the record shows the tax was used primarily for revenue-raising: at 77-78. Smith further contends that sales tax policy was further influenced by a deliberately redistributive rationale manifest in lower or no taxation on necessities and higher rates on non-essential or luxury items: 84-86.

²⁴ Although the number of schedules and their content changed many times over the years, the basic structure remained for the duration of the WST with the first schedule generally containing exempt (tax free goods) then the following schedules (of which there were up to six at various stages) containing rates for different categories of taxable (assessable) goods. Those goods not covered by a schedule were taxed at a default rate (set relatively low). See eg *Sales Tax (Exemptions and Classifications) Act 1951* (Cth) ss 5-6; *Sales Tax Act (No 1) 1951* (Cth) s 3(4). Over the first few decades of its operation, the highest rate of the WST was not necessarily conceived of, or described as, a luxury rate per se but as a rate which applied to non-essential goods: Julie Patricia Smith, 'The Changing Redistributive Role of Taxation in Australia Since Federation' (PhD Thesis, The Australian National University, 2002) 80.

²⁵ Motor vehicles were not expressly mentioned until the inclusion of motor vehicles used for the transportation of returned soldiers who lost a leg during war as exempt from sales tax in Schedule 1 of a 1947 iteration of the Act. However, motor vehicles and their component parts were included in the tax base as goods either imported or manufactured for domestic consumption being neither goods that were specifically exempt nor bound for export: *Sales Tax Assessment Act (No 1) 1930* (Cth) (enacted on 18 August 1930) s 3, s 17 (and associated Acts); Commonwealth, *Parliamentary Debates*, House of Representatives, 9 July 1930, 3902-3903 (James Scullin, Prime Minister); *Sales Tax Assessment Act (No 1) 1930* (Cth); *Sales Tax Act (No 1) 1946* (Cth); *Sales Tax (Exemptions and Classifications) Act 1947* (Cth) s 3(o) item 135.

rationales which sometimes resulted in preferential taxation and sometimes punitive taxation. With the establishment of a domestic car manufacturing industry the tax treatment of cars was sometimes motivated by protectionism and at other times by a desire to compensate for the inadequacies of the income tax be it through the failure to tax (or adequately tax) fringe benefits or to address rorts in eligible deductions such as the claiming of luxury vehicles as a business expense.²⁶ At other times, the application of sales tax to motor vehicles was deliberately motivated by a redistributive rationale expressed by a desire to more heavily tax the purchases of the luxury (or non-essential) items of the rich over the necessities of the poor.²⁷

However, it was not until the reforms of the Hawke-Labor government in 1986 that an explicit distinction was introduced into the sales tax treatment of cars based on value – with a general rate (of 20%) applied below a specified threshold and new luxury rate of 30% imposed above it.²⁸ The stated rationale was to dampen consumer demand to address the trade deficit rather than one of redistribution. However, then Treasurer Keating acknowledged that the overall package of budget measures was designed to protect the ‘most needy’.²⁹ The conservative opposition accused the government of an ‘envy spasm’ whereby the ‘envy principle overcomes economic common sense’³⁰ as well as protectionism designed to increase the price of more expensive European car imports while preserving the tax position of domestically produced cars (under the threshold).³¹

²⁶ The sales tax was but one of a number of protectionist levers used including most prominently tariffs which had been selectively applied to the import of motor vehicles since at least WWI. For an overview see: Julie Smith, ‘The Changing Redistributive Role of Taxation in Australia Since Federation’ (PhD Thesis, The Australian National University, 2002), ch 6. See reforms to limit the depreciation allowance for cars to AUD 18,000 in 1980 as a means of preventing excessive deductions for expensive vehicles: *Income Tax Assessment Act Amendment Act (No. 2) 1980* (Cth).

²⁷ See eg Chifley [Speech on the introduction of the Sales Tax legislation (Australia, Parliament, Senate and House of Representatives (Hansard) 1930b, pp. 5305–9; Commonwealth of Australia, *Parliamentary Debates*, House of Representatives, 19 August 1986, 260 (Paul Keating)]. The WST first applied a higher rate to the sale of eligible motor vehicles during the 1950s when included in the second schedule the rate of which rose from 5% to 20% across the decade. This in essence meant that motor vehicles received a kind of mid-range treatment neither exempt from tax nor taxed at the luxury rate: *Sales Tax (Exemptions and Classifications) Act 1951* (Cth) ss 5-6; *Sales Tax Act (No 1) 1951* (Cth) s 3(4). A subsequent change introduced in 1956 and remaining until the repeal of the LCT distinguished between passenger vehicles (taxed at a higher but not luxury rate) and commercial vehicles (taxed at a lower rate): See eg *Sales Tax (Exemptions and Classifications) Act 1956* (Cth) s 5; *Sales Tax Act (No 1) 1956* (Cth) s 4.

²⁸ *Sales Tax (Exemptions and Classifications) Amendment Act 1986* (Cth) s 5, schedule – Part II inserting item 39 into the second schedule of the *Sales Tax (Exemptions and Classifications) Act 1986*; Explanatory Memorandum, *Sales Tax (Exemptions and Classifications) Amendment Bill 1986* (Cth) 29, 34. The threshold was set at the wholesale price equivalent of the upper limit on which depreciation is allowable for income tax purposes on such vehicles. Only 4.5% of light vehicles were subjected to the tax in 1986: Senate Standing Committee on Economics, *Tax Laws Amendment (Luxury Car Tax) Bill 2008*; *A new Tax System (Luxury Car Tax Imposition-General) Amendment Bill 2008*; *A New Tax System (Luxury Car Tax Imposition-Customs) Amendment Bill 2008*; *A New Tax System (Luxury Car Tax Imposition-Excise) Amendment Bill 2008* (Report, August 2008) 5 [2.2].

²⁹ Commonwealth of Australia, *Parliamentary Debates*, House of Representatives, 19 August 1986, 260 (Paul Keating); ‘The savings and tax decisions...are also designed to restrain the growth of private consumption’: at 261.

³⁰ Commonwealth of Australia, *Parliamentary Debates*, House of Representatives, 12 November 1986, 1139 (Mr Carlton, liberal member for Mackellar).

³¹ ‘The Federal Budget 86-87 ‘We believe that Australia must maintain control over its own destiny’ Need to invest more, consume less’, *The Canberra Times*, 28 August 1986, 28; Senate Standing Committee on Economics, *Tax Laws Amendment (Luxury Car Tax) Bill 2008*; *A new Tax System (Luxury Car Tax Imposition-General) Amendment Bill 2008*; *A New Tax System (Luxury Car Tax Imposition-Excise) Amendment Bill 2008*

Subsequent changes made by the Hawke-Labor government in the 1990s saw the rate of tax on luxury cars briefly increase to 50% before returning back to 30%³² as well as the introduction in 1993 of a significant change in the method for calculating sales tax on luxury vehicles from one which taxed the whole value of the vehicle once it exceeded the relevant threshold to one that only applied the luxury rate to the portion of the price exceeding the threshold (thereby significantly reducing the effective rate).³³

The centrepiece of the A New Tax System Reform was the introduction of a single-rated 10 percent GST in 2000 to replace the multi-rated wholesale sales tax.³⁴ The conservative Howard government was keen to avoid the rate gradation and differential treatment under the WST. It intended to introduce a broad-based sales tax that was as neutral as possible towards market-based decisions to produce or consume thus marking a shift from the WST which bore the scars of decades of use as a tool of direct economic intervention and was susceptible to political lobbying and gaming.

Prior to the introduction of the GST, the WST contained 5 schedules with five different rates ranging from 12% (including different rates for passenger and commercial vehicles) to 30% (including luxury items such as cars) as well as exempt categories (including food and drink for human consumption).³⁵ Although the conservatives were not inclined to introduce a luxury rate within the GST itself, they were equally intent to avoid a repeat of losing the unlosable election in 1993 which was largely attributed to a clumsy attempt to introduce a GST. As one pundit described it, the LCT was intended “to avoid a repeat of the Coalition's 1993 Fightback blunder when it promised cheaper Ferraris but more expensive food.”³⁶ As the package introducing the reforms explained:³⁷

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 per cent. 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 introduce a retail tax on luxury cars, at a rate of 25 per cent of the value above a luxury threshold (a GST-inclusive value of \$60,000). The tax will ensure that luxury cars only fall in price by about the

Car Tax Imposition-Customs Amendment Bill 2008; A New Tax System (Luxury Car Tax Imposition-Excise) Amendment Bill 2008 (Report, August 2008) 5 [2.2].

³² *Sales Tax Laws Amendment Act 1990* (Cth) sch 1, s 1, 3; *Sales Tax (No 1) Amendment Act 1990* (Cth) s 3(3)(ca); *Sales Tax Laws Amendment Act (No 1) 1991* (Cth) s 4, 7; for opposition to the increase see: Commonwealth, *Parliamentary Debates*, House of Representatives, 15 May 1990, 564, 576 (Peter Reith).

³³ Explanatory Memorandum, *Sales Tax (General) (Deficit Reduction) Bill 1993* (Cth) 10-11; *Sales Tax (General) (Deficit Reduction) Act 1993* (Cth). This significant concession was partly motivated by compliance concerns (with evidence suggesting that retailers artificially reduced the selling price of cars or stripping equipment from cars to fall below the hard threshold at which the tax would literally double): Michael Lynch, ‘Car Industry Leaders Relieved at Soft Pedal Taxation’ *AFR* (18 August 1993), 3.

³⁴ *A New Tax System (Goods and Services Tax Act 1999* (Cth); *A New Tax System (End of Sales Tax) Act 1999* (Cth) s3.

³⁵ *Sales Tax (Exemptions and Classifications Act) 1992* (Cth).

³⁶ Matthew Horan, ‘Top-up levy to limit fall in luxury car prices’ *The Adelaide Advertiser*, 14 August 1998.

³⁷ ANTS Statement (1998) p 89.

same amount as a car just below the luxury threshold. Businesses subject to GST will not be able to obtain an input tax credit for the tax on luxury motor vehicles.

The reasons why cars were the only item singled out from the list of luxury items taxed under the then fifth schedule was never articulated beyond the above statement. Presumably, among a list of items which contained furs/skins, jewellery, tie pins, cuff links, watches, clocks, cameras, gaming machines, photographic and audio-visual equipment, some of which already seem quaint in their inclusion, luxury cars were the most prominent and iconic class of luxury good that justified a relative continuity of treatment.³⁸

The LCT itself has undergone a number of changes since its introduction – most in 2008 when the Labor government increased the rate from 25% to 33%.³⁹ In addition, various changes have been made for different sectors⁴⁰ such as a series of additional changes in 2008 which introduced a rebate scheme for eligible primary producers and tourism operators and a higher threshold for fuel-efficient vehicles.⁴¹

This brief history shows that although the LCT was introduced to secure the introduction of the GST, the deeper history of the sales tax treatment of cars reveals a number of other motivating factors including redistribution and a desire to supplement the deficiencies of the income tax. To suggest that having secured the introduction of the GST, the LCT is now an anachronism is a strange argument as it implies that the passage of time diminishes our concerns about the distributive implications of the indirect tax burden. While the immediate need to secure political support for a controversial reform might have dissipated, it remains the case that reform to the GST remains difficult precisely for the very distributive issues that we are now told don't matter because the progressive rate-scale of the pre-existing wholesale sales tax is no longer a relevant comparator. The underlying assumption is that our commitment to important questions around distribution are very shallow indeed.

3.2 Comparative context

Australia is not alone in applying additional taxation on the sale or importation of luxury vehicles, however, different jurisdictions attempt to do so in different ways. With the rise of general consumption taxes, namely the Value-Added Tax (or GST), over the latter part of the twentieth century and the consequential decline in

³⁸ *Sales Tax (Exemptions and Classifications) Act 1992* (Cth), sch 5.

³⁹ Commonwealth of Australia, Budget Paper No. 1, Budget Strategy and Outlook 2008-09, Canberra, 37; *A New Tax System (Luxury Car Tax Imposition—General) Act 1999* (Cth), s 4; *A New Tax System (Luxury Car Tax Imposition—Customs) Act 1999* (Cth), s 4; *A New Tax System (Luxury Car Tax Imposition—Excise) Act 1999* (Cth), s 4.

⁴⁰ Limited changes were introduced following the Ralph Review of Business Taxation such as the exclusion from the luxury tax threshold of modifications made to a non-luxury vehicle for the purposes of transporting disabled persons: see eg ANTS (LCT) Act 1999 s 5-20 (5); *Review of Business Taxation, A Tax System Redesigned, More Certain, Equitable and Durable* (Report July 1999) 331 -332.

⁴¹ *The Tax Laws Amendment (Luxury Car Tax) Act 2008* (Cth) Schedule 1; ANTS (LCT) Act 1999 s 25-1(4)-(6).

specific excises (as well as tariffs), luxury taxes are less common especially in developed countries with more robust revenue-raising capacity.⁴²

Although exemptions and concessional rate classifications are common under VAT/GST systems, higher rates are less so. This most likely reflects a desire to address the perceived regressivity of such taxes whereby often debates around the introduction or expansion of such taxes focus on the need to protect the poor.⁴³ One recent worldwide survey of 218 national jurisdictions found that only 39 had a VAT/GST or similar tax with one or more higher rate categories applying to various items such as banking and insurance, telecommunications, casinos, tourism and entertainment. Only one (India) applies this higher rate to motor vehicles.⁴⁴

Nevertheless, motor vehicles are a very frequent subject for “progressive” (increasing rate) and “luxury” rate taxation including under: specific indirect taxes such as excise taxes and select luxury taxes;⁴⁵ registration regimes or periodic taxes on ownership and/or use;⁴⁶ and through differential customs duty tariffs on imported high value vehicles.⁴⁷ In a recent review, the OECD noted a greater willingness by member states to use the taxation of motor vehicles ‘to influence consumer or business behaviour’⁴⁸ which includes other factors such as environmental considerations and other externalities not captured by price alone.

Examples of specific forms of luxury taxes on motor vehicles (with many of the initiatives recently announced) include the recent introduction of a luxury goods tax on cars, aircraft and boats proposed in Canada⁴⁹ and the introduction of a 10% tax on “ultra-luxury cars” from December 2016 in China “to combat conspicuous

⁴² See eg OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), 14-18 [1.3].

⁴³ See James, *Rise of the Value-Added Tax* (CUP; 2015), 108-109.

⁴⁴ See Fabiola Annacondia, “Overview of General Turnover Taxes and Tax Rates – January 2021” (2021) 32(2) *International VAT Monitor* 122-132: Afghanistan, Andorra, Argentina, Bangladesh, Barbados, Belarus, Brazil, China, Comoros, Egypt, Eritrea, Grenada, Guinea-Bissau, Honduras, India, Indonesia, Iran, Jamaica, Jordan, North Korea, Kyrgyzstan (sales tax), Liberia, Malaysia, Maldives, Mauritania, Myanmar, Netherlands-Antilles, New Caledonia, Pakistan, Panama, São Tome and Principe, Solomon Islands, Spain (Canary Islands), Sri Lanka, Sudan, Suriname, Taiwan, Venezuela and Yemen. Excludes Bhutan, sales tax terminating by 1 July 2021.

⁴⁵ See eg Israel which imposes an additional luxury rate for luxury vehicles above a certain threshold under its purchase tax: OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), 170-171, Annex Table 4.A (Taxes on vehicles); Russia: transport tax, with “scale-up factor” from 1 January 2014 to tax luxury cars: PwC, 2019 *Global Automotive Tax Guide* (2019) 345.

⁴⁶ OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), 171; See eg Greece which imposes a registration tax with graduated tax rate scale by vehicle value and emissions OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), Annex Table 4.A (Taxes on vehicles).

⁴⁷ See eg the Philippines imposes an excise rate of 50% on vehicles over PHP 4 million: CNN Philippines, “DTI imposes additional taxes on imported cars” (4 January 2021), [https://cnnphilippines.com/business/2021/1/4/DTI-car-imports-additional-duty.html#:~:text=Republic%20Act%2010963%20or%20the,raised%20tariffs%20on%20fuel%20products.](https://cnnphilippines.com/business/2021/1/4/DTI-car-imports-additional-duty.html#:~:text=Republic%20Act%2010963%20or%20the,raised%20tariffs%20on%20fuel%20products.;); Thailand: Wichit Chantanusornsiri, “Customs floats luxury car tax cut”, *Bangkok Post* (30 January 2018) (referring to the then 80% rate on luxury vehicles in addition to other general taxes), <https://www.bangkokpost.com/thailand/general/1404142/customs-floats-luxury-car-tax-cut>; Vietnam: VietnamNet.vn, “Vietnam’s super luxury car market shrinks because of sky-high taxes, fees” (30 October 2020) (citing increase in then luxury car tax rate of 60%, for some engine sized cars to 130% or 150%, leading to Rolls-Royce ending distribution in Vietnam).

⁴⁸ OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), 170.

⁴⁹ Budget 2021 to commence 1 January 2022: “For cars and personal aircraft, the tax would be the lesser of (i) 10% of the full value of the vehicle or aircraft and (ii) 20% of the value in excess of CAD 100,000”; See Blair P Dwyer, *IBFD Country Tax Guide – Canada, Corporate Taxation, Miscellaneous Indirect Taxes* as at 10 July 2021.

consumption and promote more fuel-efficient vehicles”.⁵⁰ By contrast, the region which hosts the most manufacturers of luxury vehicles, the European Union, has conducted a co-ordinated campaign against luxury car taxes and/or rates in the course of negotiating a series of free-trade agreements.⁵¹

In summary, as in Australia, the taxation of motor vehicles across jurisdictions is achieved across a range of revenue instruments and is motivated by a range of factors from revenue-raising to the deterrence of specific forms of consumption for environmental or other reasons.⁵²

4 Evaluating the operation and performance of the Luxury Car Tax

As Part 2 outlined, the Henry Review concluded that “[l]uxury taxes should not be used to raise revenue. They are inefficient because of their narrow base.”⁵³ The Review referred to the fact that in 2007-2008 the LCT raised \$464 million in revenue or 0.1 per cent of total taxation revenue before recommending its abolition.⁵⁴

However, this objection begs the question – at what cost? If the LCT generates this revenue for appropriately low administrative and compliance costs then the tax is not necessarily inefficient. For example, recent reforms to extend the GST to low value goods purchased online from offshore providers were hailed a success despite generating low overall levels of revenue (of \$250M from 1 July 2018-1 May 2019 or less than 1 percent of

⁵⁰ GlobalFleet, “10% tax on ultra-luxury cars in China” (2 December 2016), <https://www.globalfleet.com/fr/taxation-and-legislation/asia-pacific/article/10-tax-ultra-luxury-cars-china?a=FJA05&curl=1#:~:text=From%20next%20Thursday%2C%20buyers%20of,Bentayga%20and%20Aston%20Martin%20DB9>.

⁵¹ See eg Vietnam has agreed to phase out taxes on the importation of luxury vehicles imported from the EU from 70% to 0% over the next ten years as part of a Free Trade Agreement (FTA) signed with the EU: Phnom Penh Post, “VN taxes on EU’s cars to fall to 0%” (8 July 2019), <https://www.phnompenhpost.com/business/vn-taxes-eus-cars-fall-0>; Eu negotiators are applying similar pressure on Australia in the context of ongoing FTA negotiations: Darren Gray, ‘European Car Makers Rev-Up Push Against Luxury Car Tax’, Sydney Morning Herald, 11 October 2019, page cite. See also the failed attempt by the EU to challenge a (now abandoned) luxury car tax levied in the United States: EU v US (Taxes on automobiles) 11 October 1994, Panel Report circulated but not adopted: https://www.wto.org/english/tratop_e/envir_e/edis06_e.htm.

⁵² See generally, PWC, Global Automotive Tax Guide (2018); OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020), 169-170 [4.2].

⁵³ “Taxes with narrow bases that raise small amounts of revenue are usually inefficient unless they effectively correct for a failure in a particular market or unless they function as charges for particular goods and services” Commonwealth of Australia Treasury, Australia’s Future Tax System Review Panel, *Australia’s future tax system: Report to the Treasurer* (Australia’s Future Tax System Review Panel: The Treasury, Canberra, 2009), 469.

⁵⁴ Commonwealth of Australia Treasury, Australia’s Future Tax System Review Panel, *Australia’s future tax system: Report to the Treasurer* (Australia’s Future Tax System Review Panel: The Treasury, Canberra, 2009), 476.

GST revenue) at relatively low administrative cost (of approximately \$1.09 per \$100 in revenue collected compared to an average of \$1 across other Commonwealth taxes).⁵⁵

This section examines the revenue generated by the LCT, the nature of the tax base and the administrative and compliance costs. It shows that although the LCT (as a narrow-based tax) does not generate significant revenue, the administrative and compliance costs are appropriately low. It further demonstrates that, over the long term, the tax base of the LCT is generally increasing (albeit subject to fluctuations). This is a somewhat surprising finding given the general indictment of the tax detailed in section 2. The section then considers the primary reason for the generally solid performance of the LCT, which is that the tax is generally well-designed and administered as part of the overall GST system and it generates most revenue from a small number of large taxpayers who are well-positioned to comply. Although there is scope for improvement, such as in reviewing the threshold at which a vehicle is classified as luxury and in tightening some compliance vulnerabilities, as the majority Senate Report concluded when reviewing an increase to the LCT in 2008, “the LCT is a progressive tax which is relatively easy to collect.”⁵⁶

4.1 Revenue generation and tax base

The LCT has generated almost AUD 9 billion since its introduction at an average of AUD 446 M per year. As Table 1 shows, the revenue yield of the LCT is small – constituting just under 1% of GST revenue over the period and 0.145% of total tax revenue.

Table 1 – LCT, GST and Total Tax Revenue (TTR) from 2000-2020⁵⁷

Year	LCT revenue (\$m)	GST revenue (\$m)	TTR (\$m)	LCT as a % of GST revenue	LCT as a % of TTR
2000-01	194	28,451	175,591	0.682%	0.110%
2001-02	223	28,360	177,838	0.786%	0.125%
2002-03	275	31,032	194,881	0.886%	0.141%
2003-04	335	33,913	209,626	0.988%	0.160%

⁵⁵ ATO, GST Annual Australian Taxation Office (ATO), *GST Administration Annual Performance Report 2017–18* (ATO, Canberra, 2019), 43 Table 3.1; ATO, Media Release – GST on low value goods measure continues to exceed expectations, 4 July 2019.

⁵⁶ Standing Committee on Economics, Commonwealth Parliament of Australia Senate, *Tax Laws Amendment (Luxury Car Tax) Bill 2008* (August 2008) 12 [2.40].

⁵⁷ Author calculations based on: Australian Taxation Office 'Taxation Statistics 2018-19 - GST - Table 1', *Selected GST, WET and LCT Items, 2001–02 to 2019–20 Financial Years* (Excel Spreadsheet, 4 June 2021) Table 1 <https://data.gov.au/data/dataset/taxation-statistics-2018-19/resource/c35adafd-11a3-448b-a495-633caa45d8b9?inner_span=True>; Australian Bureau of Statistics, *Taxation Revenue, Australia, 2019-2020 Financial Year* (Catalogue No 5506.0, 27 April 2021 and previous year series). Some notable peaks and troughs can be partly explained by legislated changes such as the increase of the tax from 25 percent to 33 per cent in 2008 which resulted in increased revenues immediately prior to the change and decreased revenues immediately after reflecting the forward shifting of luxury car purchases in response to the announced changes.

2004-05	301	35,432	229,214	0.850%	0.131%
2005-06	324	37,329	245,759	0.868%	0.132%
2006-07	370	39,700	262,667	0.932%	0.141%
2007-08	447	41,792	286,322	1.070%	0.156%
2008-09	376	41,538	278,732	0.905%	0.135%
2009-10	482	44,910	268,059	1.073%	0.180%
2010-11	479	46,007	289,480	1.041%	0.165%
2011-12	441	46,807	317,986	0.942%	0.139%
2012-13	426	48,447	338,625	0.879%	0.126%
2013-14	463	51,738	352,338	0.895%	0.131%
2014-15	525	54,575	355,232	0.962%	0.148%
2015-16	609	57,302	369,257	1.063%	0.165%
2016-17	684	60,659	388,576	1.128%	0.176%
2017-18	705	63,537	427,444	1.110%	0.165%
2018-19	677	64,867	455,773	1.044%	0.149%
2019-20	591	61,359	447,608	0.963%	0.132%
Total	8927	917,755	6,071,008	-	-
Average	446.35	45,888	303,550	0.953%	0.145%

Table 1 further shows that revenue from the LCT is broadly on an upwards trajectory (subject to some fluctuations) which reflects a growing tax base. As Figure 1 shows, sales of luxury cars have risen from roughly 3-4 per cent of total vehicle sales at the time of its introduction to around 12 per cent of total vehicle sales today.⁵⁸ The long-term trend in the increased base of the LCT still exists even when factoring in fluctuations in overall car sales.⁵⁹ This upward trajectory in luxury car sales has continued even when overall car sales declined through the global financial crisis and COVID-19 - with luxury car sales reaching record highs during the pandemic.⁶⁰ This led the government to recently revise LCT collections up by 42 per cent from previous downward revisions.⁶¹

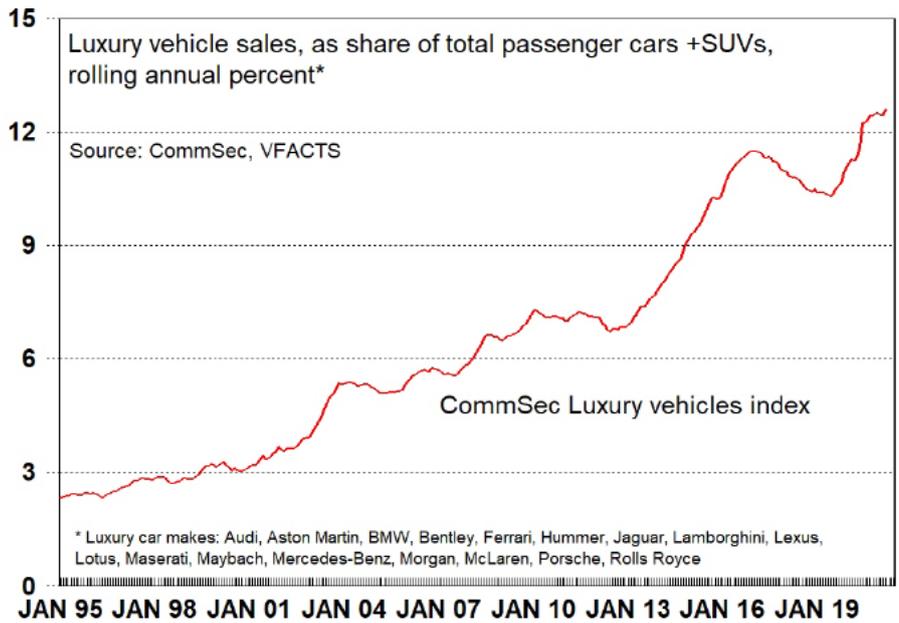
⁵⁸ Luxury car sales data in Figure 1 is compiled on a narrower base of luxury cars than appears in the LCT legislation and so underestimates the base: Commsec collects data on the 17 marquee luxury car brands listed in Figure 1: CommSec, Economic Insights: Watchful Reserve Bank. Record Luxury Vehicles (20 April 2021), 1 <file:///C:/Users/kajames/Downloads/ECO_Insights_200421-Luxury-vehicle-market-share-lifts-to-new-high.pdf>. The ANAO estimated that luxury car purchases constituted 10% or 100,000 of the total new car purchases for the 2010-2011 financial year: ANAO (2011) 25 [1.2].

⁵⁹ For data on overall car sales see, eg, ABS, Sales of New Motor Vehicles (December, 2017); post-2017 data is collected by the Federal Chamber of Automotive Industries as part of its VFACTS service. Latest data shows sales of 916,968 in 2020 down from 1,062,867 in 2019: FCAI, 'Australia's new motor vehicles market' (accessed 21 October 2021).

⁶⁰ Shane Wright, 'No recession for those in the market for a luxury car' (20 April 2021) <<https://www.smh.com.au/politics/federal/no-recession-for-those-in-the-market-for-a-luxury-car-20210420-p57kuf.html>>

⁶¹ Shane Wright, 'Better than thought but bottom line deep in red', *Sydney Morning Herald* (12 May 2021) 6. This follows downwards revisions to LCT revenues in the 2019-2020 budget which suggests the uptick in LCT revenues which follows from strong increase in luxury car sales was not foreseen by Treasury: Budget 2019-2020 – Statement 4 Revenue 5-18 (https://budget.gov.au/2019-20/content/bp1/download/bp1_bs4.pdf).

Figure 1 – Luxury vehicle sales as a share of total passenger vehicles sold (1995-2019)⁶²



Disaggregated data showing the incidence of the LCT is difficult to acquire through public sources with the Federal Chamber of Automotive Industries recording data on car sales by market segment but not necessarily in a way conducive to determining the incidence of the LCT. However, Table 2 provides the top 10 models subject to the LCT in 2010 and Table 3 estimates the top 10 vehicle makes and models for which the base price exceeds the luxury car tax threshold for 2022.

Table 2 – Most popular vehicles exceeding the LCT threshold in 2010⁶³

Rank	Model group	Sales
1	Toyota Prado	15,423
2	Toyota Landcruiser Wagon	7,273
3	Holden Commodore	6,749
4	Mercedes Benz C-Class	6,658
5	Mitsubishi Pajero	5,065
6	BMW 3 Series	4,943
7	BMW X5	3,105
8	Toyota Kluger	2,731
9	Audi A4	2,652
10	Mercedes-Benz M-Class	2,589

\

⁶² Commsec collects data on the 17 marquee luxury car brands listed in Figure 1: CommSec, Economic Insights: Watchful Reserve Bank. Record Luxury Vehicles (20 April 2021), 1 <file:///C:/Users/kajames/Downloads/ECO_Insights_200421-Luxury-vehicle-market-share-lifts-to-new-high.pdf>.

⁶³ ANAO Report (2011) 26, Table 1.1.

Table 3 - Most popular vehicles exceeding the LCT threshold in 2020⁶⁴

Rank	Make and Model group	Base price (AUD, 2021)
1	Toyota Landcruiser Wagon	80,873
2	Toyota LandCruiser 70 Series	72,043
3	Mercedes-Benz GLC wagon	70,300
4	BMW X3	73,900
5	BMW 3 Series	71,900
6	Ram 1500	79,950
7	Audi Q5	69,900
8	BMW X5	104,400
9	Mercedes-Benz GLE wagon	105,089
10	Nissan Patrol	81,160

These tables highlight a constant criticism of the LCT – which is that the threshold is too low (currently either AUD 69,152 or AUD 79,659 for fuel efficient vehicles) and so is over-inclusive of vehicles which should not properly considered luxury vehicles.⁶⁵ Based on this list, the criticism seems valid and, as section 5 and 6 contend, there is a prima facie case to made for increasing the threshold so that the tax is properly described as a luxury car tax . However, this is an objection to the operationalisation of the tax as rather than to the notion of a (properly-designed) luxury car tax.

4.2 Administration and compliance costs

While the LCT (as a narrow-based tax) does not generate significant revenue, neither does it generate significant administrative or compliance costs.

The ATO is responsible for administering the LCT on taxable supplies and for deferred payments on taxable imports, while Customs/Border Force collects the remaining 0.6% of revenue collected on taxable importations.⁶⁶ Given that the LCT raises on average 0.145% of total tax revenue it accordingly receives a low administrative priority.⁶⁷ The administration of the LCT is subsumed into the overall administration of the indirect/business tax program and therefore the ATO does not break down the administrative costs

⁶⁴ List compiled from the top 100 cars sold for 2020 and the price of the base model for the vehicles listed. As a result the list is likely under-inclusive – for example, the Toyota Prado base model falls under the LCT threshold but frequently features in lists of top selling vehicles that attract the LCT. Top-selling models that fall within the AUD 60,000 – AUD 70,000 range include: Toyota Prado (AUD 60,830 RRP ranked 8th of top-selling vehicles for 2020 and would be first on this list); Mercedes-Benz C-Class Series (AUD 66,900 ranked 69th of top-selling vehicles and would rank 6th on this list); Volvo XC6 (AUD 67,990 ranked 80th overall and would rank 8th on this list): See Justin Hilliard, “Top 100 New Cars Sold in Australia in 2020”, CarsGuide (9 January 2021) (from VFacts), <https://www.carsguide.com.au/car-news/top-100-new-cars-sold-in-australia-in-2020-82038>.

⁶⁵ Joshua Dowling, ‘Toyota drivers seeing red over tax’, *The Age* (15 June 2019) 4.

⁶⁶ Customs/Border force has collected AUD 54m of a total of AUD 8927 M collected for the period from 2000-2020 (54m / 8927m = 0.6049%): calculations from data contained in Table 1 above; ANAO (2011) 34 [2.4].

⁶⁷ ANAO (2011) 37 [2.13].

attributable to the LCT.⁶⁸ However, the Australian National Audit Office noted in a 2011 review of the administration of the LCT:⁶⁹

The LCT has been in place for almost eleven years. It is a mature tax that is well understood across the motor vehicle industry; is relatively concentrated in a small number of taxpayers; and contributes less than one per cent of total taxation revenue each year. The tax is relatively simple to administer and both the Tax Office and Customs currently apply an overall low rating to the risk of taxpayers not complying with their LCT obligations.

Although the ANAO Review is dated, there is nothing in subsequent ATO Annual Reports to suggest that the administrative profile of the LCT has changed dramatically. The LCT forms part of the general reporting and administrative provisions of the GST (or for customs duty for LCT on taxable importations).⁷⁰ This synthesised reporting and administration was designed to minimise compliance costs:⁷¹

When the tax was introduced, the additional compliance impact of the measure was considered to be marginal, as taxpayers do not have additional payment and administrative obligations, over and above their GST returns.

Most LCT taxpayers will have an ABN and be registered for GST purposes (with no separate registration for the LCT).⁷² Both taxes are reported via business activity statements (with LCT accounted for under an LCT label in a BAS return) and reporting periods and attribution rules align with the GST.⁷³ As with the GST, provision is made for adjustments.⁷⁴

The LCT has generated very few requests for interpretive assistance including which might infer “that taxpayers have a good understanding of the tax and its application.”⁷⁵ The ANAO Report noted that “[c]ar dealers interviewed were generally unconcerned with the cost of complying with the tax.”⁷⁶ However, the

⁶⁸ The only regular reporting on the LCT is in reporting annual revenue figures. The ANAO notes that the failure to disaggregate administrative costs for the LCT suggests such costs are low.: ANAO (2011) 35-41, 37 [2.12]; ATO, Annual Report 2019-2020 (2020), ch 4; author correspondence with the ATO (on file).

⁶⁹ Australian National Audit Office, *ANAO Audit Report No.45 2010–11: Administration of the Luxury Car Tax* (2011) 13 [10]. See also pp 49-50 [3.19]-[3.25] for information on how the ATO benchmarks risk including based data of luxury vehicle sales.

⁷⁰ ANTS (LCT) Act 1999 Pt 3, s 13-20, 13-25; ANTS (GST) Act 1999 Div 17.

⁷¹ ANAO Report (2011) 30 [1.19].

⁷² ANAO (2011) 30 [1.20].

⁷³ ANTS (LCT) Act 1999 s 13-5, 13-15 (1), (1A).

⁷⁴ An increasing adjustment is required when more LCT is payable such as where LCT was not paid because the vehicle was intended to be used as trading stock but then later used privately. A decreasing adjustments occurs when less LCT is payable including for bad debts: ANTS (LCT) Act 1999 s 13-10, div 15. Separate credit and recovery provisions apply for taxpayers who are not registered under the GST: ANTS (LCT) Act 1999 div 17; ANAO (2011) 53 [3.37].

⁷⁵ ANAO (2011) 16 [22], 47 [3.13]. This observation was supported by feedback from taxpayers and industry associations that “the application of the tax...was well understood across the industry: 16 [23]. A search of the ATO database revealed three class rulings dealing with issues such as whether a vehicle is properly classified as a luxury or commercial vehicle: see eg CR 2012/81, CR 2012/37, CR 2001/1. Beyond LCT which specify the LCTT each year, there is only one LCT Determination on a substantive issue (whether the finance component of the cost of a luxury car acquired under a hire-purchase agreement is included in the LCT value (it is not)): LCTD 2014/1. [Search conducted 17 September 2021].

⁷⁶ ANAO Report (2011) 42 [2.36].

ANAO Report noted that because the LCT is a low administrative priority for the ATO, there was a need to better coordinate administration so that risks are genuinely low rather than not being detected.⁷⁷

Relatively low administrative and compliance costs most likely result from the LCT revenue being highly concentrated - with a small number (100 or 6 percent) of taxpayers (including car retailers, importers, wholesalers and manufacturers) contributing the bulk of revenue (84% in 2009-2010).⁷⁸ They are also likely a product of the legislative design and implementation of the LCT which is integrated into to the design and administration of the GST (explored below) and partly a product of its economic incidence (explored in part 5).

4.4 Legislative scheme

The LCT is payable (at a rate of 33%)⁷⁹ on a *taxable supply*⁸⁰ or *taxable importation*⁸¹ of a *luxury car*⁸² when the *luxury car tax value*⁸³ of that vehicle exceeds the *luxury car tax threshold* ('LCTT')(currently set at \$69,152 or \$79, 659 for fuel-efficient cars).⁸⁴

As with the WST that preceded it, the LCT is only payable on the value of the car that exceeds the *luxury car tax threshold*. Although the calculation of car's value for the purposes of establishing the LCTT is GST-inclusive, LCT is only payable on the GST-exclusive portion of the value of the vehicle above the relevant

⁷⁷ ANAO (2011) 36-37, [2.10]-[2.15], 55-56 [3.48] - "shortcomings in individual components of overall compliance arrangements limit the assurance that taxpayers are meeting their LCT obligations."

⁷⁸ ANAO (2011) 45, [3.2]. Up until 2011 annual LCT revenue was typically paid by less than 1000 taxpayers (approximately 59 per cent of the 1692 taxpayers with an LCT account). at 31 December 2010, there were 379 motor vehicle entities in the large market segment, of which 138 entities were LCT taxpayers: ANAO Report (2011) 17 [29], 26 [1.9] – Figure 1.1, 30 [1.21], 53 [3.33]. This reflects a generally held position in the literature that compliance costs are lower for tax instruments that collect revenues from a small number of taxpayers with greater ability to pay, as opposed to collecting revenues from a larger number of taxpayers with lesser ability to pay: David Gamage, *How Should Governments Promote Distributive Justice: A Framework for Analyzing the Optimal Choice of Tax Instruments*, (2014) 68 *Tax L. Rev.* 1, 34.

⁷⁹ *A New Tax System (Luxury Car Tax Imposition—General) Act 1999* (Cth), s 4; *A New Tax System (Luxury Car Tax Imposition—Customs) Act 1999* (Cth), s 4; *A New Tax System (Luxury Car Tax Imposition—Excise) Act 1999* (Cth), s 4.

⁸⁰ ANTS (LCT) Act, s 5-10.

⁸¹ ANTS (LCT) Act 1999, s7-10.

⁸² *A New Tax System (Luxury Car Tax) Act 1999*, div 5, div 7; s25-1, 27-1 - Car means a motor vehicle (including 4 wheel drives but excluding motor cycles) that is designed to carry a load of less than 2 tonnes and fewer than 9 passengers or a limousine. The definition excludes emergency vehicles, cars fitted out for transporting disabled people in wheelchairs, commercial vehicles (other than passenger vehicles) and motor homes and campervans.

⁸³ The *luxury car tax value* is determined differently for taxable supplies (price of the car including GST and customs duty but excluding other taxes (including the LCT), fees and charges payable on the supply and inclusive of modifications made by the recipient of the supply or their associates (except for those necessary for transport or use of the vehicle for disabled persons): s 5-20) and taxable imports (the sum of amounts payable that constitute customs value of the car and any car parts, accessories or attachments, charges for international transport and insurance for the transport; customs duty payable and GST payable: s 7-15): ANTS (LCT) Act 1999.

⁸⁴ The LCTT is the car depreciation limit that applies under applicable income tax legislation (itself a tax integrity measure introduced in 1980 to prevent excessive income tax deductions for (luxury) motor vehicles). The LCTT is indexed annually: ANTS (LCT) Act 1999 s 25-1; ITAA 1997 s 40-230 (and the former sub-div 42-B); ATO, 'Luxury car tax rate and thresholds' (28 May 2021) <<https://www.ato.gov.au/rates/luxury-car-tax-rate-and-thresholds/>>.

LCT threshold.⁸⁵ The LCT applies to eligible purchases by both final consumers and businesses, but there are specific rebates available for primary producers and tourism operators.⁸⁶

The tax points which trigger tax liability rely heavily on the GST legislation for their content either through the using the same form of words, specifically incorporating terms and definitions from the GST Act or a combination of both. For example, a *taxable supply of a luxury car* is defined in the LCT Act, and by reference to the GST legislation.⁸⁷ As with the GST, the term has positive elements (such as the requisite connection to Australia and requirement that the supply be made in the *course or furtherance of an enterprise that is carried on* by a supplier who is *registered or required to be registered*)⁸⁸ and negative elements⁸⁹ (excluding situations when a recipient quotes for the supply of a car (see below) or when the car is more than two years old).⁹⁰

Similar to the GST, a *taxable importation of a luxury car* triggers LCT liability if the luxury car (including parts and accessories)⁹¹ is *imported and entered for home consumption*⁹² regardless of whether the importer is registered or carrying on an enterprise (and so applies to private buyers). The definition excludes certain importations such as when a quote is made for the importation of the car or LCT has already become payable.⁹³

A system of *quoting*⁹⁴ enables suppliers⁹⁵ or importers⁹⁶ of vehicles who are registered under the GST Act to defer the payment of the LCT when intending to acquire the car for one of three permitted purposes: (1) to use the car as trading stock; (2) for research and development for the manufacturer of the vehicle; or (3) when exporting the car in circumstances where it would be a GST-free export.⁹⁷ This deferral of payment is designed to avoid the tax being payable until it reaches a final or business consumer,⁹⁸ but presents an obvious

⁸⁵ ANAO (2011) 29 [1.16].

⁸⁶ ANTS (LCT) Act 1999 div 18.

⁸⁷ For example, the ‘taxable supply of a luxury car’ is defined in s5-10, but its constitutive terms of ‘supply’ and ‘taxable supply’ take their meaning from the GST Act: ANTS (LCT) Act 1999 s5-10, s27-1 – ‘supply has the meaning given by section 9-10 of the GST Act’, ‘taxable supply has the meaning given by s195-1 of the GST Act’; ANTS (GST) Act 1999 s 9-10, s 195-1.

⁸⁸ ANTS (LCT) Act, s 5-10. The definition of taxable supply of a luxury car specifically excludes situations where the recipient quotes for the supply of the car, where the car is more than two years old or where the car is exported and GST-free: s 5-10 (3).

⁸⁹ ANTS (GST) Act 1999, div 9 cf ANTS (LCT) Act, div 5.

⁹⁰ Any subsequent supplies of the vehicle in the remaining two-year period needing to take account of any LCT already paid on a taxable supply or importation: ANTS (LCT) Act 1999 s 5-15(2). A further exclusion includes when the car is exported in circumstances that it is GST-free: at s 5-10 (3).

⁹¹ Importation of the car includes any car parts, accessories or attachments that are imported at the same time as the car and that could reasonably be expected to be fitted to the car. This would be intended to prevent breaking up cars into component parts to avoid the LCT (but would presumably not prevent a scheme whereby the component parts of a luxury car were imported across a series of imports). However, the case law suggests such practices have not occurred (or at least not to generate case law) which suggests that costs of avoiding the LCT in this manner might outweigh the benefits: ANTS (LCT) Act s 7-10(2), ANTS (GST) Act 1999 (Cth) s 195-1 ‘car parts’.

⁹² ANTS (GST) Act 1999, div 11 cf ANTS (LCT) Act, div 7, s 7-10; *Customs Act 1901* (Cth), s 68.

⁹³ Further exclusions include when the importation is for a specifically excluded purpose (eg public display by an endorsed public institution such as a museum) or a non-taxable re-importation occurs ANTS (LCT) Act s 7-10(3), 7-20, s27-1.

⁹⁴ ANTS (LCT) Act 1999, pt 2 div 9.

⁹⁵ ANTS (LCT) Act 1999, s5-10(2).

⁹⁶ ANTS (LCT) Act 1999, s7-10(3).

⁹⁷ ANTS (LCT) Act 1999, s9-5.

⁹⁸ Explanatory Memorandum, A New Tax System (Luxury Car Tax) Bill 1999 (Cth) 2.3, 9.

vulnerability because it enables the tax to be avoided on otherwise eligible supplies and importations. This risk is reflected by the insertion of penal provisions designed to prevent improper quoting.⁹⁹ Both the GST and the LCT are subject to specific anti-avoidance rules (eg associate provisions)¹⁰⁰ and the general anti-avoidance rules in the GST legislation apply to the LCT.¹⁰¹

The amount of luxury car tax payable is calculated according to the following formula:

$$\text{Rate} \times (10 \div 11)^{102} \times [LCTV - LCTT].^{103}$$

Figure 1 provides a worked example.

Figure 1 – Calculation of LCT on a luxury vehicle (not fuel-efficient)

Leviathan Showrooms sells a Rolls-Royce Ghost for \$628,000 including GST (but excluding on-road costs). The car is not fuel efficient. The LCT value of the car is above the relevant threshold and the LCT applies as follows:¹⁰⁴

$$(\$628,000 - \$69,152) \times 10 \div 11 \times 33\%$$

$$33\% \times 10 \div 11 \times [628,000 - 69,152]$$

$$558,848 \times 10 \div 11 \times 33\% = \$167,654.40.$$

Leviathan Showrooms charges their customer Alexis Downer \$795,654.40 (\$628,000 including GST (of \$57,090) plus \$167,654.40 LCT) for the vehicle excluding stamp duty, insurance, registration and other charges. Total Commonwealth tax paid is \$224,745.31 (approximately 28% of the purchase price).

4.5 Case law and compliance

Further evidence of the low administrative and compliance burden of the LCT is the relatively small number of disputes which before the Administrative Appeals Tribunal (AAT) and the courts. Since its introduction, the LCT has been the primary subject of a total of eight litigated disputes (and featured peripherally in a further

⁹⁹ ANTS (LCT) Act 1999 s 9-10(4) (obligation to notify the supplier if not eligible to quote on a supply – 20 penalty units) and s 9-30 penalties for improper quoting – 20 penalty units.

¹⁰⁰ ANTS (LCT) Act 1999, s 5-20(2)-(4).

¹⁰¹ ANTS (GST) Act 1999 div 165; ANTS (LCT) Act 1999

¹⁰² The luxury car tax was intended to apply to the GST exclusive price of the car. Consequently, the amount of tax payable on the difference between the LCTT and LCTV (which includes the GST) is obtained by multiplying this amount by 10÷11: Explanatory Memorandum, A New Tax System (Luxury Car Tax) Bill 1999 (Cth) 1.13, 7.

¹⁰³ A New Tax System (Luxury Car Tax) Act 1999 (Cth) s 5-15 (for taxable supplies), s 7-15 (1) (for taxable importations).

¹⁰⁴ See further, ATO, 'Working out the LCT on a Sale' 28 May 2021 <<https://www.ato.gov.au/business/luxury-car-tax/working-out-the-lct-amount/working-out-the-lct-on-a-sale/>>

20 or so disputes) with one resolved by the Full Federal Court,¹⁰⁵ two by a single judge of the Federal Court¹⁰⁶ and the remainder by the AAT. All but two cases concerned overlapping issues with the GST and LCT (most common being entitlement to input tax credits under the GST and entitlement to quote for the LCT) and all but one case concerned attempts to misuse the quoting mechanism to avoid paying LCT.¹⁰⁷

The case law highlights that the major compliance risk for the LCT is misuse or abuse of the quoting mechanism (to wrongly defer payment of the LCT). The cases all involve individuals or entities attempting to take advantage of the quoting mechanism to avoid payment of LCT by (wrongly) claiming a quotable purpose primarily by wrongly claiming that they are a luxury car dealer who is purchasing the car solely as trading stock (or by failing to provide adequate evidence to support such a claim)¹⁰⁸ or by interposing (sham) entities or transactions with a view to establishing a quotable purpose (to acquire luxury vehicles as trading stock) and obscuring an otherwise taxable transaction.¹⁰⁹ In reality, the vehicles are variously used for 'extended' test drives, personal use or informally leased or sold.¹¹⁰ Surprisingly, no case has yet considered the application of the anti-avoidance provisions despite the implied sham-nature of some of the arrangements.

Compliance risks are exacerbated by the relatively lax registration requirements for the LCT - neither the ATO nor Customs/Border Force apply any additional measures to verify registrations for an LCT account (beyond the general registration requirements of the GST)¹¹¹ which means that a “business entity with no prior or

¹⁰⁵ *Dreamtech International Pty Ltd v Federal Commissioner of Taxation* (2010) 187 FCR 352 – considering whether a stretch hummer was included in the definition of limousine and determining the ordinary meaning of the undefined term ‘limousine’ was one of fact not law (thereby limiting the Federal Court’s ability to review merely to whether the term was used beyond its ordinary meaning (it was not) and whether there was sufficient material before the Tribunal to justify the meaning it gave (there was)).

¹⁰⁶ *Melbourne Car Shop Pty Ltd v Commissioner of Taxation* (2010) 76 ATR 42 (Jessup J)(car dealer of low-mid-range cars failed to establish luxury cars bought for a new venture in luxury car sales when, in reality, the purchases were for the taxpayer’s father); *Stallion (NSW) Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1306 (Thawley J).

¹⁰⁷ The remaining case concerned the meaning of the undefined term ‘limousine’ in the definition of luxury car: *Dreamtech International Pty Ltd v Federal Commissioner of Taxation* (2010) 187 FCR 352.

¹⁰⁸ *Melbourne Car Shop Pty Ltd v Commissioner of Taxation* (2010) 76 ATR 42 (Jessup J) (car dealer of low-mid-range cars failed to establish luxury cars bought for a new venture in luxury car sales when, in reality, the purchases were for the taxpayer’s father); *Re Davsa Forty-Ninth Pty Ltd (as Trustee for the Krongold Ford Business Unit Trust) and Federal Commissioner of Taxation* (2014) 98 ATR 671 (applicant failed to show luxury vehicles acquired for a quotable purpose (in the capacity of a luxury car dealership for use as trading stock)); *Re Criterion Prestige Pty Ltd and Federal Commissioner of Taxation* (2015) 97 ATR 465 (surgeon claiming to run a luxury car dealership to avoid LCT not supported by the evidence (no anti-avoidance argument pursued by the Commissioner)); *Mavris and Commissioner of Taxation (Taxation)* [2018] AATA 1825 (taxpayer was a car dealer and occasional trader in luxury vehicles failed to discharge evidentiary burden in support of a quotable purpose (to use the cars as trading stock) for some claims and succeeded in others); *Skourmallas and Commissioner of Taxation (Taxation)* [2019] AATA 5535 (taxpayer satisfied tribunal that he operated a small luxury car dealership and therefore the Tribunal accepted that eight luxury vehicles were acquired for a quotable purpose (as trading stock)).

¹⁰⁹ *The Trustee for the Star Enterprises Trust (Eurodrive Tours Pty Ltd) and Commissioner of Taxation (Taxation)* [2020] AATA 1656 (bogus loan transactions attempted to disguise that the luxury vehicles were taxable transactions as opposed to trading stock); *Stallion (NSW) Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1306 [195]-[248](Thawley J)(taxpayer failed to show assessment by Commissioner was excessive – failed to show that the interposed entity (to take advantage of the quoting mechanism to avoid LCT (and claim input tax credits)) was not acting as an agent and failed to show that the arrangement was not a sham – no anti-avoidance arguments run by Commissioner).

¹¹⁰ ATO, Get Your LCT Right (11 February 2021) < <https://www.ato.gov.au/Business/Luxury-car-tax/Get-your-LCT-right/>>; Fleur Anderson and Angus Grigg, ‘Luxury car rort spurs tax debate’, *The Australian Financial Review* (14 June 2011) 1.

¹¹¹ ANAO (2011) 18 [31], 51 [3.28], [3.29].

current dealings in motor vehicle sales can register for LCT.”¹¹² Risks can consist of entities registering for the LCT but not reporting any transactions and entities that should register for LCT but failing to do so. The ATO lists additional compliance risks as ‘organised criminal networks infiltrating the luxury car industry to launder money, hide assets and commit tax fraud, including LCT fraud.’¹¹³

So far, these risks have not been reflected in the case law but might explain an increase in the tax gap (which measures revenue lost to non-compliance) for the LCT from 3.4% in 2014-2015 to 7.8% in 2017-2018.¹¹⁴ However, this tax gap is comparable to an overall average tax gap across all taxes of 6.9%¹¹⁵ including the GST which had a tax gap of 7.3% for 2017-2018.¹¹⁶ The ATO notes that the LCT tax gap is subject to fluctuations in the sale of luxury cars,¹¹⁷ but the extent to which compliance risks appreciably increase, there is obvious scope for tightening the rules around registration and the quotation system.

As the preceding analysis has shown, if we accept the LCT for what it is (ie a narrow select excise on a single item of consumption expenditure being luxury cars), the tax is, on the whole, well designed and performs well. That is, the LCT generates revenue relatively efficiently at low administrative and compliance costs and from an increasing rather than shrinking tax base. One important reason for this somewhat surprising finding is that, as sections 2.1 and 2.4 show, the LCT is drafted and implemented to complement the GST. The legislation adopts similar legislative criteria for triggering tax liability, for example, in adopting the same terms of *taxable supply* and *taxable importation* which are defined in line with the GST legislation. The legislation synthesizes the accounting, reporting and payment requirements of the LCT with the GST.¹¹⁸ In many respects, the LCT might be properly described as a component of the GST system which is reflected by the ATO’s approach to administering the LCT which is to subsume it into overall indirect tax administration.¹¹⁹ This is not to say that there is no scope to improve the tax as there are valid concerns expressed over certain aspects of its design

¹¹² ANAO Report (2011), 18 [31], 51 [3.28], [3.29].

¹¹³ ATO, Get Your LCT Right (11 February 2021) < <https://www.ato.gov.au/Business/Luxury-car-tax/Get-your-LCT-right/>>.

¹¹⁴ The LCT tax gap was: 3.4% or AUD 18M revenue in 2014-2015, 10.1% (AUD 69M) for 2015-2016; 5.8% (AUD 42M) for 2016-2017 and 7.8% or AUD 52 M in 2017-2018: ATO, Annual Report 2019-2020 63, Table 3.5. The ATO measured LCT gap at 3.3% : eg in 2013-2014: ATO, Annual Report 2014-2015 (2015) 42, Table 2.2.

¹¹⁵ The tax gap across all taxes of was 7.7% (2015-2016); 7.2% (2016-2017) and 6.9% (2017-2018): ATO Annual Report 2019-2020 63 Table 3.4.

¹¹⁶ The tax gap for the GST of 7.5% (AUD 4,453M) in 2014-2015; 8.2% (AUD 5,146) in 2015-2016; 6.9% (AUD 4,527M) in 2016-2017; 7.3% (AUD 4,978M) in 2017-2018 and 8.1% (AUD 5,776M) in 2018-2019: ATO, *Annual Report 2019-2020* (2021) 63, Table 3.5.

¹¹⁷ The ATO attributes the tax gap to the “strong discretionary nature” of spending on luxury cars as well as “movements in macroeconomic factors, such as the exchange rate and house prices” which “in turn reflects the high correlation of luxury car prices with the Australian dollar (AUD) exchange rate” given the majority of vehicles subject to LCT are imported ATO, ‘Luxury Car Tax Gap – Trends and Finding’ <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Luxury-car-tax-gap/?page=2#Trends_and_latest_findings> (19 October 2020).

¹¹⁸ *A New Tax System (Luxury Car Tax) Act 1999*, div 5 (taxable supplies of luxury cars mirroring div 9 GST Act), div 7 (taxable importation of luxury cars mirroring div 13 GST Act), div 13 (LCT is added to net amounts under Div 17 of the GST Act), the Div-165 anti-avoidance rules in the GST legislation apply to both GST and LCT (s 13-1, s13-30); Explanatory Memorandum, *A New Tax System (Luxury Car Tax) Bill 1999* (Cth) 2.18, 11.

¹¹⁹ For a dated albeit comprehensive overview see: ANAO Report (2011)

and operation such as the threshold at which it applies and the system of quoting which can be exploited to avoid the tax.

5 The efficiency case for and against the LCT

A further objection generally levelled at the LCT is that in targeting a single item of expenditure the LCT is distortive and arbitrary in its effect as was articulated in a 2008 Discussion Paper released by the Henry Review:¹²⁰

Addressing non-tax policy objectives with taxes on specific goods and services has complex effects. To the degree that there is some substitutability between different forms of consumption, non-uniform tax rates encourage the production and consumption of less taxed goods.

To paraphrase the objection, if we tax luxury cars (and therefore increase the market price for those cars) then people might instead purchase other things such as mid-range cars or other luxury items that are not so heavily taxed such as Harley-Davidsons or yachts which, in turn, might mean that manufacturers and importers might favour the production and importation of these items over luxury vehicles.¹²¹ To articulate the presumption behind these statements – taxation should not interfere with production and consumption choices because allowing such decisions to be made according to market-based criteria best maximises individual and therefore collective welfare (or utility).¹²²

The argument is superficially appealing but over-simplifies a contested literature which includes qualified objections that highlight the many ways in which markets fail to maximise welfare¹²³ and more foundational

¹²⁰ Commonwealth of Australia Treasury, Australia's Future Tax System Review Panel, *Architecture of Australia's Tax and Transfer System* (Commonwealth of Australia Treasury, Canberra, 2008) 281; Henry Review (2009) 469.

¹²¹ See, eg, Louis Kaplow, *The Theory Of Taxation and Public Economics* (2008, Princeton University Press) 122; Andrew McPherson, Sharon Guffogg, Sae Takemoto & Scott Williams, (2011) 4(1) *Deakin Papers on International Business Economics* 17, 19-20.

¹²² See, eg, Ian Crawford, Michael Keen and Stephen Smith, 'Value Added Tax and Excises' in Adam, Stuart et al (eds) for the Institute for Fiscal Studies, *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, Oxford, 2010) 275, 283; Andrew McPherson, Sharon Guffogg, Sae Takemoto & Scott Williams, (2011) 4(1) *Deakin Papers on International Business Economics* 17, 19 presumes that "a policy of unhindered free trade maximizes welfare and enables markets to achieve efficiency in equilibrium"; The authors of a leading Australian tax textbook repeat the general refrain, 'in general, the impact of tax should not influence individual or business choices by artificially distorting or altering the costs (and therefore attractiveness) of alternative goods, different modes of investment or different activities.' Woellner, Robin, et al, *Australian Taxation Law* (CCH Australia, 20th ed, Sydney, 2021), 1-200.

¹²³ See, eg, Joseph E Stiglitz, 'Development-Oriented Tax Policy' in RH Gordon (ed) *Taxation in developing countries: six case studies and policy implications* (Columbia University Press, New York, 2010) 11, 14; Secretariat - United Nations Conference on Trade and Development, *Trade and Development Report, 2012* (UNCTAD/TDR/2012) (United Nations Publications, Geneva, 2012), 118 - "However, the idea that tax "neutrality" increases economic efficiency derives from an economic model that does not take account of the numerous cases of market failures and unequal initial endowments that occur in the real world, and which discriminatory taxation seeks to correct...It also neglects the role of income distribution in determining the level of domestic demand: Secretariat - United Nations Conference on Trade and Development, *Trade and Development Report, 2012* (UNCTAD/TDR/2012) (United Nations Publications, Geneva, 2012), 118.

objections to the very notions of a pre-tax market position and post-tax interference.¹²⁴ For now it suffices to deal with the narrow economic case on its own terms.

While the use of excise taxes to distort or change behaviour is generally accepted when addressing a negative externality (such as the use of excise taxes to discourage alcohol and tobacco consumption and to fund the health costs imposed by such behaviours), the use of excise taxes or select commodity taxes to redistribute is more controversial.¹²⁵ However, as this section shows, the use of excise taxes to promote distributional concerns is long-standing and exists independent of any claims made about externalities. As the quote from the Henry Review acknowledges, the effects of differential commodity taxation are complex and that the economic case against imposing a higher rate on luxury cars is not nearly so clear-cut.

The first and most important point to make is that part of the objection of the Henry Review to the LCT is that there are better instruments available to achieve the desired goals. In the context of attempting to achieve environmental goals such as fostering the uptake of fuel-efficient vehicles this would be some kind of comprehensive carbon tax or pricing mechanism. In the context of redistribution, this is the personal income tax and spending. As the Henry Review states:¹²⁶

Taxes on luxury goods can act as an instrument of redistribution by imposing high rates of tax on goods and services that are exclusively or at least predominantly consumed by the wealthy. However, they are a relatively unattractive means of redistributing income. They may have had a role when the administration of a more comprehensive income tax was not feasible, but today's personal tax system, combined with a sophisticated system of transfer payments, is a far superior instrument for the redistribution of income.

However, with Australia having dismantled the carbon pollution reduction scheme, and continuing to undermine the redistributive capacity of the income tax, this paper contends that there remains a qualified case for the LCT (as a third-best option).

This paper does not dispute the superiority of an ideal income tax over an ideal commodity tax as a redistributive tool (providing better information on ability to pay and fewer distortions in behaviour).¹²⁷ However, one key point of difference is that whereas this paper contends that it makes sense to tax *all* income

¹²⁴ Liam Murphy and Tom Nagel, *The Myth of Ownership* (2000) 74.

¹²⁵ The use of excise taxes for redistribution is not generally conceived of as addressing negative externalities, however, for arguments as to why expenditure on luxury items creates negative externalities see Part 6.

¹²⁶ Henry Final Report, 475.

¹²⁷ See eg Anthony B Atkinson and Joseph E Stiglitz, "The Design of Tax Structure: Direct versus Indirect Taxation" (1976) 6 *Journal of Public Economics* 55, 68, 70, 74 - who showed that under certain assumptions redistribution is best achieved through a tax on labour income rather than excise taxes with differential rates because the former only resulted in one distortion (incentivising (untaxed) leisure over labour) rather than a double distortion (labour to leisure distortion (because it reduces the returns to labour by increasing the costs of products purchased with that income) and interfering with consumption preferences (by taxing goods differentially)); Louis Kaplow, *The Theory Of Taxation and Public Economics* (2008, Princeton University Press) 122.

on a progressive basis,¹²⁸ the Henry Review adopts a pro-consumption tax position in favouring the progressive taxation of labour income but a deliberately concessionary approach to the taxation of capital income based on familiar (but contested) claims that to tax capital income is distortionary.¹²⁹

Irrespective of who is right or wrong on this measure, it is clear that the Henry Review position predominates. The redistributive capacity of the income tax has been progressively undermined by both deliberate design and permissive neglect. The first has occurred by policy prescriptions which deliberately hollow the base (such as the generous treatment of capital income through superannuation tax concessions, generous discounts on certain types of capital gain and the continued campaign to reduce the corporate income tax)¹³⁰ and reduce the progressivity of the personal income tax (such as the legislated rate reduction and compression of personal income tax rates).¹³¹ The second results from a regulatory structure that facilitates tax gaming whereby high wealth and income taxpayers can defer or shelter income through the use of trusts and corporate entities.¹³²

Two consequences follow from this pro-consumption tax consensus. The first is that there is a tension in the Henry Review favouring neutrality in commodity tax settings (thereby favouring a single-rated GST and rejecting the LCT) and deferring to the income tax and transfer system to address distributive concerns. This is because the same preference for neutrality is used to argue against the taxation of capital income and wealth (and in other instances to arbitrarily cap spending),¹³³ thus reducing the very capacity of the income tax (and transfer system) to redistribute.¹³⁴ The second consequence is that if the trend of eroding the redistributive capacity of the income tax is long-standing enough, then a question might be raised as to whether it should be factored into the initial design of other taxes. As Crawford Keen and Smith notes in their review of the VAT

¹²⁸ See, eg, Peter Diamond and Emmanuel Saez, 'The Case for a Progressive Tax: From Basic Research to Policy Recommendations' (2011) 25(4) *Journal of Economic Perspectives* 165, 167-183 Cf Anthony B Atkinson and Joseph E Stiglitz, 'The Design of Tax Structure: Direct versus Indirect Taxation' (1976) 6 *Journal of Public Economics* 55, 57.

¹²⁹ *Henry Review*, Part 1, 32. For criticisms of the claims, see eg, Daniel Shaviro, 'Beyond the Pro-Consumption Tax Consensus' (2007) 60 *Stanford Law Review* 745, 746-747; Joseph Stiglitz 'In praise of Frank Ramsey's Contribution to the Theory of Taxation' *The Economic Journal* (2015) 125 March 235, 245-246; David Gamage, 'How Should Governments Promote Distributive Justice: A Framework for Analyzing the Optimal Choice of Tax Instruments' (2014) 68 *Tax Law Review* 1, 7. For the classic summary of the divide between income and consumption taxation see, e.g. William Andrews, 'A Consumption-Type or Cash Flow Personal Income Tax', 87 *Harvard Law Review* (1974) 1113; Alvin Warren, 'Would a Consumption Tax be Fairer Than an Income Tax?', 89 *Yale Law Journal* (1980) 1081.

¹³⁰ See, eg, Australian Treasury, *Tax Benchmarks and Variations Statement 2019* (2020) 17 – Table 3.1.

¹³¹ The government brought forward the second stage of its partly implemented Personal Income Tax Plan which ultimately seeks to significantly flatten and reduce personal income tax rates: see, eg, *Treasury Laws Amendment (Personal Income Tax Plan) Act 2018*; *Treasury Laws Amendment (Tax Relief So Working Australians Keep More Of Their Money) Act 2019*; *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020*, sch. 1.

¹³² Vann provides an account of both these trends: Richard Vann, 'In Defence of the Income Tax' (2019) 34(4) *Australian Tax Forum* 831, 835, 837-850.

¹³³ See for example the self-imposed cap on government spending as a percentage of GDP (of 23.9 per cent): Hon Hon Josh Frydenberg (Treasurer), 'Budget 2019-20, Budget Speech' (2 April 2019) <<https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/speeches/budget-speech-2019-20>>

¹³⁴ See, for example, the Review's recommendation to apply a 40 per cent discount to most interest income, net residential rental property income, capital gains and certain interest expenses thus extending the current concessional treatment of capital gains for certain individuals, trusts, small business and eligible superannuation funds to a broader range of income from savings: *Henry Review Pt 2, Vol 1, 62-85, 70 – Recommendation 14*. Despite acknowledging the efficiency benefits of taxing wealth in the form of a bequest tax, the Review demurred for reasons of political sensitivity. at 137-46, 144 – Recommendation 25.

and excises for the Mirrlees Review in the UK, “one key insight” from the optimal tax literature on commodity tax structures is “that the case for...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 subsidizing) income.”¹³⁵

In relation to the LCT, we might express this as follows: in light of the reduced capacity of the income tax to achieve progressivity and the fact that highly targeted transfers are only designed to compensate the poor, are there arguments grounded both in efficiency and fairness for using select excise taxes on luxury?¹³⁶ The remainder of this section examines the efficiency arguments, section 6 address the fairness concerns.

One argument for the use of select excises rests on empirical evidence which shows that that the response of the rich to higher income taxation is not one of substituting leisure for work (as is often assumed by the economic models) but rather is one of engaging in tax gaming to minimise or shelter that income from tax.¹³⁷ Gamage contends that once tax gaming is taken into account, it makes sense to use “supplementary policy options” such as luxury excise taxes that have the same distributional goals (to redistribute from the rich to the poor) that cannot be gamed in the same way.¹³⁸ In other words, to the extent that a high wealth individual has employed tax and corporate structures to defer and shelter income, then there are efficiency reasons for attempting to get a share of that otherwise taxable income through other tax instruments which include: reducing the incentive to game in the first place by ensuring that any gain will be taxed (albeit once spent);¹³⁹ ameliorating incentives to substitute leisure for labor;¹⁴⁰ and, providing more accurate information on actual economic capacity rather than the taxable capacity minimised by tax gaming.¹⁴¹ The trend revealed in section 4.1, for sales of luxury cars to increase during times of economic downturn might lend support for the LCT as a means to capture revenue foregone to tax gaming (assuming this is the case). This argument is not without

¹³⁵ CKS (2017) 284; Anthony B Atkinson and Joseph E Stiglitz, ‘The Design of Tax Structure: Direct versus Indirect Taxation’ (1976) 6 *Journal of Public Economics* 55, 74 - the “Ramsey-style results would, therefore, only be relevant where there were constraints on the use of income taxation.” See also Cnossen (2010) 236.

¹³⁶ See eg Joseph Stiglitz ‘In praise of Frank Ramsey’s Contribution to the Theory of Taxation’ *The Economic Journal* (2015) 125 March 235, 243, 247.

¹³⁷ Joel Slemrod and Shlomo Yitzhaki, ‘Tax Avoidance, Evasion, and Administration’ in 3 *Handbook of Public Economics* (Kenneth J. Arrow & Michael D. Intriligator eds., 2002) 1423, 1447-49; Joel Slemrod, ‘The Economic consequences of taxing the rich’ in Slemrod, Joel (ed), *Does Atlas shrug? The economic consequences of taxing the rich* (Russell Sage Foundation; Harvard University Press, New York, 2000), 17-19; Diamond and Mirrlees did not factor in tax evasion in their analysis: Peter Diamond and James Mirrlees, ‘Optimal Taxation and Public Production II: Tax Rules (1971) *American Economic Review* 261, 278.[Note Apps 2021 paper in support of this finding].

¹³⁸ David Gamage, ‘How Should Governments Promote Distributive Justice: A Framework for Analyzing the Optimal Choice of Tax Instruments’ (2014) 68 *Tax Law Review* 1, 3, 39;

¹³⁹ Gamage (2014) 44.

¹⁴⁰ Although you might work less to avoid an income tax on your labor, the excise tax then reaches your expenditure consumption: Gamage (2014) 43.

¹⁴¹ Gamage (2014) 49-50. Gamage highlights additional considerations which add to the case of select excises include the degree to which tax-gaming generates negative externalities and political economy considerations such as that if supplemental taxes cannot be gamed in the same way as the income tax then it might make sense to rely on more rather than fewer instruments: 65-66, 70-71.

its critics,¹⁴² but it is important to note that Gamage contends that the argument best applies to incremental rather than fundamental reforms. In other words, it is a way of getting the rich to pay something in the absence of major reform but not to give up on the idea of properly reforming the income tax or of on relying on other supplementary options such as wealth and transfer taxes.¹⁴³ Although there is an obvious fairness rationale to this argument, it is important to note here that the case for luxury excise taxation here is made on efficiency not fairness grounds.

Having established a prima facie case for retaining select luxury excise taxes (due to the decline in the redistributive capacity of the income tax), it is worth turning to the vast the literature on the optimal rate-setting for commodity taxation which shows that a uniform commodity tax rate is not always optimal.¹⁴⁴ Under certain conditions¹⁴⁵ tax rates might vary according to the relative elasticity of a good (the inverse elasticity rule) with low rates on goods and transactions for which taxpayers are most likely to alter their behaviour in response to taxation (for example where demand is elastic eg fairy floss) and higher rates on those goods where people are less able to alter their behaviour (where demand is inelastic eg bread).¹⁴⁶ Related factors include the substitutability of a taxable good with another and the extent to which a good is a complement to leisure (with higher rates on goods that are a complement to leisure such as a luxury yacht and lower rates on those that substitute for leisure (eg uniforms)).¹⁴⁷

The uncertainty around the effects of deploying differentiated commodity tax rates and the practical difficulties in implementing them, has meant that the dominant preference is to apply flat-rate commodity taxes. However, this preference is motivated by pragmatics (eg to prevent political lobbying and gaming) not

¹⁴² Louis Kaplow, *The Theory Of Taxation and Public Economics* (2008, Princeton University Press) 122

¹⁴³ Gamage (2014) 3, 85-6; See further: David Gamage, 'The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth' (2015) 68 *Tax Law Review* 355.

¹⁴⁴ For a good summary of the main contributions see Ian Crawford, Michael Keen and Stephen Smith, 'Value Added Tax and Excises' in Adam, Stuart et al (eds) for the Institute for Fiscal Studies, *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, Oxford, 2010) 275, 284-291.

¹⁴⁵ For example, Ramsey ignored distributional concerns and assumed no income tax "I propose to neglect altogether questions of distribution and considerations arising from the differences in the marginal utility of money to different people; and I shall deal only with a purely competitive system with no foreign trade". Ramsey's results held for "small" or "infinitesimal" revenues: FP Ramsey, 'A Contribution to the Theory of Taxation' (1927) 37(1) *Economic Journal* 47, 47, 58, 55-60. "The Ramsey-style results would, therefore, only be relevant where there were constraints on the use of income taxation": Anthony B Atkinson and Joseph E Stiglitz, 'The Design of Tax Structure: Direct versus Indirect Taxation' (1976) 6 *Journal of Public Economics* 55, 74

¹⁴⁶ *Price elasticity* refers to the extent to which the supply and demand of a good is responsive to changes in price, and therefore to taxation that is incorporated into that price. FP Ramsey, 'A Contribution to the Theory of Taxation' (1927) 37(1) *Economic Journal* 47, 55-60; Ian Crawford, Michael Keen and Stephen Smith, 'Value Added Tax and Excises' in Adam, Stuart et al (eds) for the Institute for Fiscal Studies, *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, Oxford, 2010) 275, 284-291; William M Gentry, 'Optimal Taxation' in JJ Cordes, RD Ebel and J Gravelle (eds), *Encyclopedia of Taxation and Tax Policy* (2nd ed, Urban Institute Press, Washington DC, 1999) 281-283.

¹⁴⁷ WJ Corlett and DC Hague, 'Complemetarity and the Excess Burden of Taxation' (1953) 21 *Review of Economic Studies* 21, 21-30. See further: Joel Slemrod, 'Optimal Taxation and Tax Systems' (1990) 4(1) *Journal of Economic Perspectives* 157, 159; Gentry at 281-283; CKS (2017) 289, Table 4.1. The extent to which luxury cars are a complement to leisure seems a plausible assumption given unless one drives, sells or services such cars for a living it is more likely to be a complement to leisure than labour.

by purely economic concerns.¹⁴⁸ This gives rise to the question – if the economic case for graduated commodity taxation is arguable but uncertain, then what of the specific case for taxing luxury cars?

In summary, the theoretical and empirical case for taxing luxury cars is relatively strong. Cnossen, for example, concludes that, provided that the settings are right, unlike most other luxury items, it makes sense to tax luxury cars as part of “progressivity enhancing excise duties” for two main reasons.¹⁴⁹ First, because consumption of luxury cars is highly income elastic (meaning such purchases are generally the preserve of the rich not the poor) but consumption patterns for luxury cars within this high-income group are relatively inelastic (meaning that consumption occurs irrespective of price (including tax)).¹⁵⁰ Second, because such taxes are administratively feasible to collect with goods able to be precisely defined and categorised while the sheer size of cars and the need to register such vehicles to use them means consumption is more difficult to conceal or shift.¹⁵¹

These theoretical benefits are borne out by the empirical analysis in Part 4 which showed that the tax is relatively efficient to administer and comply with and, although the purchase of luxury cars can fluctuate with market conditions (such as changes in the exchange rate), they are relatively invariant to the tax levied on them (other than in timing of purchases when changes are made (as occurred in 2008) or by tax gaming (which can be addressed by tightening administration and design)). There is, however, a prima facie case to be made for increasing the threshold at which the LCTT applies which might require further investigation. One option might be to set the threshold to align with the various state-based stamp duty threshold (of \$100,000 for luxury vehicles).¹⁵²

To the extent that there might be other commodities which exhibit similar features to luxury vehicles – in essence to a limited class of luxury assets where the response to the tax is relatively inelastic and where administration and compliance costs are relatively low – then an argument might be made for extending it. Cnossen observes that higher ad-valorem taxes on “pleasure boats, and private aircraft are appropriate” for

¹⁴⁸ Crawford, Keen and Smith (Mirlees) accept the case for rate differentiation but for reasons of simplifying administration prefer a single rate: CKS 286, 288-291, 350-351. These include specific concerns around how a VAT would accommodate rate differentiation because of the potential to exploit the refund mechanism (by claiming refunds on high value goods while paying VAT on low-value sales: 350. See also Gamage 51

¹⁴⁹ Sjibren Cnossen, ‘Reform and Coordination of Indirect Taxes in the ASEAN free trade area’, *Tax Notes International* 11 Feb 2013, 589, 609. Although Cnossen himself concludes that there is no role for luxury excise taxes (absent externalities) in Australia because of the strength of the income tax and transfer system, given this paper raises questions about the reliability of that conclusion, one can see that there are in fact theoretical grounds for the LCT: Sjibren Cnossen, ‘Excise Taxation in Australia (2010), 239.

¹⁵⁰ Cnossen (2013) 609-610.

¹⁵¹ Cnossen notes that, by contrast, expenditure on cosmetics is higher as a percentage of income for low-income rather than high-income households and the ability to conceal and import items such as jewellery and audiovisual equipment from abroad makes the imposition of such tax luxury taxes difficult to justify and administratively difficult: Cnossen (2013) 609, 610.

¹⁵² Cnossen stipulates that the rate of a LCT should be set at a level appropriate to the price-elasticity of luxury cars: Cnossen (2013) 609-610. Any changes would need to consider the impact on depreciation limits to the income tax (which inform the general LCTT).

similar reasons.¹⁵³ Similarly, there is a case for the taxation of luxury housing but Cnossen suggests that this is properly through the property tax system.¹⁵⁴ Press reports suggest that the draftspeople charged with designing the LCT initially considered extending its application to luxury boats but did not do so.¹⁵⁵ Few would query that private aircraft is an item of luxury expenditure (although there might be issues around characterising the expense as business or personal which would need to be addressed in the drafting). Likewise, with appropriate setting of thresholds and definitional clarity to exclude income-producing assets, extending the tax to luxury boats might be justified on similar grounds. However, further theoretical and empirical work may be required to test if such items would be as robust against avoidance (with boats and aircrafts more readily able to be registered elsewhere).¹⁵⁶ Recent reforms in Canada to tax luxury vehicles and aircraft (above a threshold of \$100k) and boats (above \$250k) will be instructive.¹⁵⁷

6 Fairness

The Henry Review further objected to the LCT on fairness grounds arguing that the tax violated principles of vertical equity and horizontal equity. The former because:¹⁵⁸

People with the same economic means will pay different amounts of tax depending on their tastes. Wealthy people with modest tastes pay less than wealthy people with a preference for luxury goods. Australia's current luxury tax, the luxury car tax (LCT), is particularly arbitrary in its impact. It falls on people with a preference for relatively expensive cars, but not on those with a preference for diamonds, fur coats or yachts.

On its face the objection appears convincing. If we are committed to taxing everyone equally according to ability then people with the same economic capacity should pay the same irrespective of their personal predilections. However, the statement is an over-simplification of the economic literature. For example, if viewed narrowly through the social-welfare function, Atkinson and Stiglitz highlight that in “the case where

¹⁵³ Cnossen (2013) 610.

¹⁵⁴ Cnossen (2013) 610.

¹⁵⁵ Phillip Coorey, 'The politics of axing the luxury car tax' Australian Financial Review (online) 20 February 2020. The report suggests that the inclusion of boats was abandoned because if a common threshold was adopted across cars and boats too many (non-luxury) boats would be included. This is a problem that can be readily fixed by adjusting thresholds according to the item of expenditure and would not prove too burdensome if the extension of the LCT was to a limited class of high-value assets.

¹⁵⁶ The US Congress introduced a luxury tax on yachts, private aeroplanes, furs, jewellery and cars in 1990 which was repealed with retrospective effect in 1993 for all items other than cars which generated 90 % of revenue (but the taxation of which ended in 2002). It is not entirely clear if the repeal was based on economic analysis alone (some claimed that because the demand for yachts is elastic but the supply inelastic that the effective burden fell on producers rather than consumers and contributed to the decline of the domestic yacht-building industry) or effective political lobbying. See further, United States General Accounting Office, 'Tax Policy and Administration: Luxury Excise Tax: Issues and Estimated Effects' (GAO/GGD-92-9, February 1992) 2-7, 32 (noting insufficient data to establish the effects of the tax).

¹⁵⁷ Government of Canada, *Consultation on the Select Luxury Goods Tax* (13 August 2021) 2-3.

¹⁵⁸ Henry Review (2008) 475; See also Standing Committee on Economics, Commonwealth Parliament of Australia Senate, *Tax Laws Amendment (Luxury Car Tax) Bill 2008* (August 2008) 23.

tastes differ”,¹⁵⁹ the condition for “horizontal equity is not, therefore, uniform taxation; only if the price elasticity is the same...would uniform tax rates be horizontally equitable.”¹⁶⁰ So there might be a case for uniform taxation of chocolate and vanilla ice-cream but not necessarily for the taxation of luxury cars and ice-cream or diamond rings because if “the demand of one for his commodity is more elastic than the demand of the other for his, the former will suffer the larger hurt.”¹⁶¹

As was detailed in Part 4, elsewhere the Review is not committed to taxing everyone equally according to ability with the Review expressly favouring the preferential treatment of capital income over labour income. Similarly, we might therefore contend that the objection that the LCT falls unevenly on luxury preferences is not necessarily an argument to do away with the tax provided that we think there is a good reason to tax people differently on the basis of those preferences.

The Henry Review further objected to the LCT for violating principles of vertical equity, that is the rich should pay more than the poor, because:¹⁶²

Very few luxury goods are the exclusive preserve of the wealthy. Some of the burden of the LCT falls on people of average means with a preference for relatively expensive cars. In some cases, this reflects the fact that price is an arbitrary proxy for luxury within a given product category. Many people would feel that a small sports car is luxurious at \$60,000 but a 7-seater minivan is not luxurious at the same price

Again, the superficial appeal of such an objection does not withstand closer scrutiny. It seems both an overstatement to claim that ‘price is an arbitrary proxy for luxury’ as well as an undermining of the Review’s otherwise steadfast commitment to the efficiency of markets. As Part 4 highlighted, expensive luxury cars are the type of goods that tend to primarily constitute the expenditure of the wealthy provided that the threshold is set right. While we might object, in principle, to a seven-seater minivan attracting the tax,¹⁶³ this objection can be addressed by design – and in particular at the appropriate setting of the threshold at which the tax applies. If set appropriately to include clearly-in luxury items then the objection falls away. To put it crudely, there are not too many suburban battlers getting around in Maseratis

If we move beyond the narrow assessment of assessing economic justice according to vertical and horizontal equity,¹⁶⁴ then there are further reasons for specifically taxing the specific expenditure of the rich. The

¹⁵⁹ Anthony B Atkinson and Joseph E Stiglitz, “The Design of Tax Structure: Direct versus Indirect Taxation” (1976) 6 *Journal of Public Economics* 55, 70.

¹⁶⁰ Anthony B Atkinson and Joseph E Stiglitz, “The Design of Tax Structure: Direct versus Indirect Taxation” (1976) 6 *Journal of Public Economics* 55, 73.

¹⁶¹ AC Pigou, *A study in public finance* (1947, Macmillan,) 77.

¹⁶² Henry Review (2008) 475.

¹⁶³ In passing, it is worth noting that a quick review of the top 5 7-seater people-mover vans in Australia show the majority of models fall below the LCT threshold: <https://www.caradvice.com.au/top-5/people-movers/>.

¹⁶⁴ Murphy and Nagel (2000, OUP) 13-16.

remainder of this section highlights some relevant arguments made within a vast and contested theoretical literature.¹⁶⁵ The first and foundational point to make is that, as a matter of justice, assessing the impact of an individual's consumption expenditure should not begin and end at the individual or with a limited comparison of like individuals with similar capacities but different tastes. Both the capacity to spend and the exercise of that capacity by spending money to buy particular goods and services are affected by, and in turn have effects on, both the individual and the collective. The capacity to spend might be influenced by a mix of social cooperation, luck, talent or hard work. The exercise of that capacity (by spending money on particular things) is determined by resource scarcity, availability of alternatives and substitutes etc.¹⁶⁶ The choice to exercise that capacity by spending on specific items of consumption (or certain patterns of expenditure) over others likewise has consequences that extend beyond the mere individual alone.

Frank's work, for example, highlights the efficiency costs or externalities of expenditure on positional goods, such as luxury cars,¹⁶⁷ whereby the consumption patterns of the rich in particular exert a significant influence on the consumption preferences of those below and trigger a kind of positional arms race of (wasteful) and ever-increasing expenditure on items that only contribute to advancing social standing (but welfare loss).¹⁶⁸

Alternatively, a Rawlsian approach might highlight the impact of conspicuous consumption in undermining the fair system of social cooperation and reciprocity required in order to satisfy the requirements of justice in a democratic society.¹⁶⁹ There is something deeply troubling to the democratic narrative that we are all in this together and to the maintenance of the *mutual respect* required to survive wars and pandemics when, at a time when many are forced out of their livelihoods, the sales of luxury vehicles are reaching record highs.¹⁷⁰ Importantly, this is not a matter of envy, but one of facilitating the reciprocity required to support social

¹⁶⁵ Not all arguments grounded in justice will favour taxing the specific consumption of the rich: see eg Louis Kaplow, 'Choosing Expensive Tastes' (2006) 36(3) *Canadian Journal of Philosophy* 415; GA Cohen, 'Expensive Tastes Rides Again' in Michael Otsuka (ed) *On the Currency of Egalitarian Justice, and Other Essays in Political Philosophy*, edited by, (2011; Princeton University Press) 81-115.

¹⁶⁶ Landes refers to consumption as a 'realized preference' meaning that 'individuals are not taxed on their preferences, but on the overlap between them, their capacities and the options that are available at the time of the choice.': Xavier Landes, 'Why Taxing Consumption? Justifications, Objections and Social Cooperation' in Helmut P. Gaisbauer, Gottfried Schweiger and Clemens Sedmak (eds) *Philosophical Explorations of Taxation and Justice*, (2015; Springer) 101, 115.

¹⁶⁷ 'A positional good is one whose utility depends strongly on how it compares with others in the same category...A positional externality occurs when new purchases alter the relevant context within which an existing positional good is evaluated': Robert Frank, 'Should public policy respond to positional externalities?' (2008) *Journal of Public Economics* 1777, 1777.

¹⁶⁸ Robert Frank, 'Should public policy respond to positional externalities?' (2008) *Journal of Public Economics* 1777, 1777-1779; Robert Frank, *The Darwin Economy: Liberty, Competition, and the Common Good* (Princeton University Press, 2011) 61. These externalities combined with a desire to preserve market incentives lead Frank to favour a progressive consumption tax levied on the individual (levied on the individual and consisting of income minus savings with the balance taxed at progressive rates). However, the policy prescription is not inevitably tied to the problem he identifies: Robert Frank, 'Should public policy respond to positional externalities?' (2008) *Journal of Public Economics* 1777, 1783-1785; Robert Frank, *Falling Behind: How Rising Inequality Harms the Middle Class* (2013, University of California Press), ch 11.

¹⁶⁹ John Rawls, *Justice as Fairness: A Restatement*, (2001, The Bellknapp Press of Harvard University Press) 6, 76-77, 122-124; John Rawls, *A Theory of Justice* (1999, revised ed) 89

¹⁷⁰ John Rawls, *A Theory of Justice* (1999, revised ed) 154-155, 447-448.

cohesion.¹⁷¹ By extension, one might further observe that the consumption preferences of the rich shape the production decisions or options of the poor. This might be evidenced by numerous historical example such as the use of black slaves as domestic servants in southern US states (or in Australia or South Africa) or the replacement of 40 percent of South Asia’s rainforests with plantations for cash crops.¹⁷² In the context of cars, few could dispute the resource intensity required to produce a car. Although a luxury car tax levied in one rich nation cannot address this inequity,¹⁷³ the point serves to highlight the extremely limited conception of justice adopted by the Review when assessing fairness from such a narrow framing of vertical and horizontal equity.

The extent to which consumption is recognised as the product of social cooperation and as having consequences on the fair terms of that cooperation, the more likely we are to accept the imposition of limits or imposts on that consumption including the conspicuous consumption of the rich at a time of growing inequality and need. As a result, the best case that might be made for the taxation of luxury cars might lie in a combination of recognising the social act and costs of consuming luxury cars as well as a pragmatic appeal to administrability, meaning that we tax luxury cars because we can (and should).¹⁷⁴

7 Conclusion

Despite the repeated calls to repeal the LCT, this article has found that far from there being no merit in the luxury car tax, there is sufficient merit to warrant the retention of the tax. While the LCT is neither a first- or second-best option, its retention has merit based on a number of factors which include revenue-generation as well as redistributive, efficiency and fairness rationales. These rationales have informed the deeper history of the LCT as well as similar policy instruments elsewhere. It is a strange claim that the only yardstick by which we should judge the tax is set at a particular point in time (when comparisons could be made between the GST and the WST).

¹⁷¹ John Rawls, *A Theory of Justice* (1999, revised ed) 464-474; John Rawls, *Justice as Fairness: A Restatement*, (2001, The Bellknop Press of Harvard University Press) 195-197; Cf Ronal Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* 66-68.

¹⁷² See, eg. Thavolia Glymph, *Out of the House of Bondage: The Transformation of the Plantation Household*(CUP; 2008); Inara Walden, ‘“That Was Slavery Days”: Aboriginal Domestic Servants in New South Wales in the Twentieth Century’ (1995) 69 *Labour History*, 196; MH Nunes, T Jucker, T Riutta et al. ‘Recovery of logged forest fragments in a human-modified tropical landscape during the 2015-16 El Niño.’ (2021) 12 *Nature Communications* 1526.

¹⁷³ For proposals that do try to address the global distributional issues see, eg, Pogge proposes a global resources dividend (GRD) - a tax levied on the sale and extraction of natural resources to fund the global poor to meet their basic needs with dignity: Thomas Pogge, *World Poverty and Human Rights* (2008, 2nd ed, Polity Press), 202 – 221; Timothy Mawe and Vittorio Bufacci, ‘The Global Luxuries Tax’ in Helmut P. Gaisbauer, Gottfried Schweiger and Clemens Sedmak (eds) *Philosophical Explorations of Taxation and Justice*, (2015; Springer) 203 (propose a global levy on the sale of luxury goods and services to contribute to a Global Poverty Fund to alleviate the worse cases of global poverty).

¹⁷⁴ A 2020 PWC report suggests introducing a luxury rate into the GST to address the regressivity issues: PWC, ‘Where next for Australia’s tax system? How GST reform can help reboot prosperity for Australia’ (July, 202), 15.

The LCT performs relatively well given its intention - generating an appropriate share of revenue from its narrow (but increasing) base at appropriately low administrative and compliance costs. Section 4 revealed the efficiencies that result from the LCT being legislated and administered as part of the overall system of administering the GST and falling on a small number of well-resourced taxpayers with good capacity to comply. Section 4 also highlighted tensions and vulnerabilities in the legislative design and implementation of the LCT such as the low threshold at which a vehicle is considered a luxury vehicle and in the quotation system which has proven vulnerable to avoidance and evasion. However, these are vulnerabilities which can be addressed by reforms to the design of the tax itself and do not warrant its repeal.

Parts 5 of the paper challenged the Henry Review's conclusion that the LCT is inefficient because it is distortive. Although accepting the Review's conclusion that the progressive income tax and transfer system are the best methods to redistribute, the paper queried the Review's commitment to this endeavour when the ability of the income tax to do so has been undermined by legislative intent and permissive neglect which affects the ability to collect revenue from the top end of the income distribution in particular. In this context, there is a general claim to be made on efficiency grounds for retaining the LCT as a supplement to the income tax in a system where revenue is otherwise foregone by tax gaming. There is also a specific case to be made on efficiency grounds for taxing luxury cars in particular with theoretical and empirical evidence showing that expenditure on such items tend to be the preserve of the rich whose consumption of such items is relatively inelastic. It is worth investigating whether there is scope to expand the base to include other luxury items which might satisfy this criteria as with the recent reforms to tax luxury boats and planes in Canada.

Part 6 challenged the narrow articulation of unfairness by the Review and pointed to the manner in which such questions need to extend beyond regarding expenditure on consumption by reference to its impact on the individual or like individuals. A broader recognition of consumption as an act that is facilitated by and impacts on social co-operation and cohesion offers a basis for taxing the conspicuous consumption of the rich especially at a time of growing inequality and need.

Importantly, the case made for the retention of the LCT and its possible expansion is a qualified one. Assessment as to the relative efficiency of the tax might change based on taxpayer behaviour and other factors. It might be that with proper large-scale reform, the income tax and transfer system can do a better job at redistribution (especially from the top end) and the repeal of the LCT might follow. However, the pro-consumption tax position adopted by the Henry Review and legislated reforms (and failure to reform) to date provide little comfort that this will be forthcoming. Politically, the retention of the LCT might be a useful bargaining chip that can be sacrificed to strengthen the taxation of capital income when negotiating an overall package of reforms. However, the difficult debates that will be needed as part of such a reform process must move beyond discussions of reform that offer little more than the articulation of the views of a minority of

Work in Progress/Draft only – not to be disseminated reproduced without permission

affected taxpayers or associated interest groups who oppose a tax that they perceive to be damaging to their interests at the expense of the majority who benefit from the revenue derived.