Good Riddance to Bad Tax Rorts

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Tax concessions for private cars were a mighty costly way to get a little assistance to our local producers. A history lesson – and a reminder of what the market economy is all about – from Ian McAuley.

The reaction to the Government's promise to close a tax loophole – a loophole which had allowed a tax deduction on the use of private cars – has verged on the hysterical.

The change is no more than an overdue cleaning up of tax laws. It removes an anomaly, or a "rort" in everyday terminology, which had effectively allowed a tax deduction for cars provided to certain employees even if they were not used for business purposes.

We all know that we are guilty of fraud if we claim a tax deduction for our holiday travel or personal telephone. But such behaviour has been legal for cars provided as part of a "salary package", even if those cars were purely for private use.

A little history explains how this anomaly came about. In 1986 the Hawke-Keating government reformed business and personal taxes to ensure that "in-kind" payments to employees, such as school fees, club membership and utility bills, were treated no more favourably than payments made in cash. In fact, as a discouragement, the tax rate applied to such perks, the Fringe Benefits Tax, was at the highest marginal rate of personal tax.

There are sound reasons for encouraging the employment contract to be in cash. Payment in-kind is a relic from feudal times. Corporate perks belong to a paternalistic and manipulative "employer"/"employee" relationship, and whatever motivational benefit they confer is often offset by their arousal of jealousy and resentment. Taken to their extreme, when they form a large part of remuneration, they come close to the dependency seen in indentured labour – a dependency known as "golden handcuffs".

As any Economics 1 student knows, you are almost always better off when you choose how to spend your own earnings, rather than having your choices constrained by the limited offering of an employer or a salary packaging contractor. When you are paying your own way you are likely to take more care over the type of car you buy and how you look after it. And, from the company's perspective, a straight salary is much easier to administer than a set of fringe benefits. It's a fundamental principle of business that business and personal transactions should be kept entirely separate.

The 1986 reforms were designed to support these business and economic principles, but cars were exempted from these reforms, and were allowed a concessional rate of FBT. This was to give support to the local car manufacturing business – in other words, a subsidy.

You won't find that in official government statements, because, under GATT rules, which later morphed into WTO rules, we weren't supposed to subsidise specific industries, and the official line was that we were reducing tariff assistance to the car industry. All countries with car industries find their own ways around WTO rules, and this was our workaround.

Although that subsidy has never been evaluated (that would be to admit our breach of trade rules), it was probably effective in its time, because in the 1980s at least two thirds of cars sold in Australia were locally-made, supported by a 57.5 per cent import duty.

It also helped perpetuate a lazy business practice by local producers, who were making three quarters of their sales to fleet buyers – one half to businesses and one quarter to governments. Only Toyota was making significant sales to private buyers, while at the other extreme only 16 per cent of Ford's sales were to private buyers. (Try to think of anyone who ever bought a new Falcon.)

That was 27 years ago. Imports now command 80 per cent of our car market (pdf). While many government buyers still have a local preference, no such bias necessarily applies to the private sector. And, as we have been so stridently made aware, a whole industry has grown up around fringe benefits tax concessions. Part of the concession is now supporting the car industry in Germany and Japan, and, until last week, another large chunk was going to salary packaging consultants. It's a costly way to get a little assistance to our local producers.

So why such a chorus of complaint?

It is understandable that the "salary packaging" industry" would complain, and we naturally sympathise with those who have lost their jobs, such as the 74 retrenched employees of NLC, described by their boss as "a lot of good people working really hard". But that begs the question: what sort of government policy has resulted in so many good and hard-working people working in an industry which is no more than a bureaucratic overhead on the real economy? Surely such people should be better employed doing something useful.

Understandably the industry is put out by the lack of consultation, but that would not have been feasible, because the very hint of a change would have resulted in a rush of orders. It's the same reason why governments have to keep some budgetary decisions secret.

Similarly it is hardly surprising that South Australian Premier Jay Weatherill should be upset, but his advisors must have known that at some time this concession had to go. After all, successive governments have been under pressure to clean up loopholes in taxation legislation. Rather than fighting for retention of the concession, he would do better to argue for a more direct form of assistance to the industry – in a way that doesn't get siphoned off by the tax minimisation industry.

The most hypocritical reaction has been from the Coalition, who have promised to oppose the reform. How can a politician from a party ostensibly committed to choice, the simplification of regulation and the operation of free markets, support such paternalistic and discriminatory employment practices? Even Karl Marx acknowledged that capitalism was superior to feudalism. And how does their support for the "salary packaging" industry relate to their promise to reduce the size of the public sector? Are they really saying "public bureaucracy bad, private bureaucracy good"?

Particularly unedifying has been the argument between Joe Hockey and Chris Bowen as to whether low or high income workers are enjoying the benefits. We don't know who is right, but it is disingenuous for Hockey to argue that lower-paid workers are the main beneficiaries, because, if that is so, they are the very people who may benefit the most from payment in cash rather than in the form of a new car. And isn't the Liberal Party supposed to be the champion for farmers, the self-employed, retired people, stay-at home parents and others who don't have a paternalistic employer paying a salary? Perhaps their indignation is a response to their realisation that a Labor government is implementing a policy from the Liberal Party platform.

Perhaps some of the anger is from those who claim to speak for "business interests", but are really more interested in preserving ways for managers and other stakeholders to extract personal gain from businesses. We are hearing the same voices as in 1986 when the FBT was introduced, defending tax deductible "business entertainment". We are rightly annoyed when we have reason to believe that trade union officials have used union credit cards for personal expenses, but we are supposed to take a more permissive attitude when businesspeople do the same.

The only significant group with a legitimate ground for complaint are those state and local governments which have used salary sacrificing for cars as a means of providing employee benefits, while living within their budgetary constraints. Unlike private businesses, they cannot easily pass their costs on to customers. This strengthens the case for reforming Commonwealth-state tax arrangements, rather than retaining a loophole in taxation law. Many charities too benefit from this and other FBT concessions, which have been used, de-facto, as a means of reducing income tax rates in the low-paid NGO sector. But the Productivity Commission, in accordance with orthodox economic principles, has pointed out (pdf) that this is a poor way of helping that sector. (Many smaller NGOs find the administration of these concessions to be a huge bureaucratic load.)

The probable result of abolishing this concession will be a shift of some car sales from fleet to individual purchases, and a better deal for that majority of Australians who don't have access to salary sacrifice arrangements, or who do have such access but prefer to make their own choices. It may mean a lowering of car prices for such buyers, who, to date, have effectively cross-subsidised fleet buyers, particularly for Australian-made cars, and those car companies may have to pay a little more attention to individual customers. Some people will need to keep travel records, but can anyone seriously argue that logging business trips for 12 weeks every five years is a serious burden? And corporations may at last be able to simplify their payrolls and leave people free to choose how they spend their own money. Isn't that what a market economy is all about?