Australian Automotive Dealer Association Ltd.
ACN: 167 598 085
The Sir Jack Brabham Automotive Centre of Excellence
8/2728 Logan Road, Eight Mile Plains, Brisbane Queensland 4113

CEO - David Blackhall
P.O. Box 4530 Eight Mile Plains QLD 4113
0413 007 833
dblackhall@aada.asn.au

Policy Director
Michael Deed
0417 742 956
mdeed@aada.asn.au

19 January 2017

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Lodgement via email

Dear Sir/Madam

AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION (AADA) 2017-18 PRE-BUDGET SUBMISSION

1. Introduction

1.1 AADA is responding to the invitation from the Minister for Small Business the Hon Michael McCormack MP to make a submission prior to the 2017-18 Budget noting the Government's commitment to economic growth, job creation, and to sensibly and responsibility restrain government expenditure. We recognise the fiscal and political constraints as the Government prepares its 2017-18 Budget and the recognition that the Australian economy continues to transition from the investment phase to the production phase of the mining boom. We also note in MYEFO 2016-17 the Government's commitment to boosting jobs, investment and growth in regional Australia.

1.2 Against that background, we draw your attention to structural changes occurring in the automotive value chain with the cessation of motor vehicle manufacturing in Australia in 2017. This together with the financial impact of regulatory intervention on the franchised motor vehicle dealer network in Australia could have a significant impact on budgetary forecasts.

2. AADA

2.1 AADA is the peak industry advocacy body exclusively representing franchised new car dealers in Australia. There are around 1500 new car dealers in Australia that operate about 2600 new vehicle outlets. Dealerships range from family-owned small businesses to larger businesses including three public companies (AHG Ltd, AP Eagers Ltd and Autosports Group Ltd) operating in regional Australia and capital cities across all States and Territories. It is important to note that these listed entities account for around 12 per cent of total 'rooftops'. Put another way, 88 per cent of franchised new car businesses continue to be owned by individual operators or family groups. This is not a retail industry dominated by large multinational operators. This is not an industry with monopoly market dynamics such as have been allowed to develop in banking or groceries in Australia.

2.2 This is an industry predominately of small to medium enterprises (SMEs) but with important economic consequences for our country. The franchised dealer network generates revenue in excess of $66 billion, employs more than 66,000 people, pays wages in excess of $4 billion annually and has invested around $17 billion in facilities. Dealership agreements are subject to the *Franchising Code of Conduct*.

3. Background of Australian new vehicle industry

3.1 The automotive retail sector in Australia is regarded as the most competitive in the world. Around 67 brands offer more than 400 models for customers in a relatively small market of just over 1.1 million units annually (less than 1.5 per cent of global demand). The competition between dealers is fierce and consumers are not lacking in choice, with a wide range of model specifications on offer and manufacturer warranties protecting consumers for between 3 and 7 years with optional fixed price servicing also a common feature in the market (over and above the consumer guarantees provided under law).

4. Competitiveness of global markets[1]

	Australia	Canada	UK	USA
No. brands in market	67	49	53	51
Sales	1,112,032	1,620,221	2,249,483	13,040,632
Market size per brand	16,597	33,066	42,443	255,699

[1] Australian Government, Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, 2013 Automotive Update.

4.1 The Australian motor vehicle market is close to saturation point with an estimated vehicle density of close to 685 vehicles per 1,000 people. In Australia today, there are approximately 17.2 million registered road vehicles (excluding trailers).

4.2 The economic impact of the automotive retail sector in Australia is not insignificant and provided a direct contribution to Australian GDP of $7.8 billion in 2015 and a total economic contribution of $17.5 billion, which makes up 2 per cent of the Australian total economy.

4.3 Competition in the industry has increased significantly over time challenging all aspects of a dealership's revenue streams.

4.4 New car dealers in Australia operate a business model that requires considerable business acumen to achieve a nuanced balance between five important profit centres:

- new car department;
- used car department;
- parts, accessory and aftermarket sales;
- service workshop sales; and
- finance and insurance commissions.

4.5 Studies by Deloitte and others show that a modern well run Australian franchised new car dealership will generally achieve a net profit of around 2 per cent to revenue – that is to say two dollars of profit for every one hundred dollars of sales revenue. Coles and Woolworths by comparison generally achieve 5-7 per cent. These studies also show that in 2015 about 19 per cent of all franchised new car dealers failed to make a profit.[2]

4.6 Motor vehicle manufacturers compete in a globalised mainly free trade market. Even for high-end, luxury and prestige brands, investments in manufacturing plant and equipment can only be paid back by relentless attention to appropriate scale. This translates into unremitting pressure to win and retain customers and so deliver the required volume of sales at the retail end of the business.

4.7 As a matter of policy all manufacturers and distributors operating in Australia have attached significant proportions of retail dealer margin to the achievement of ambitious but attainable Customer Satisfaction Index (CSI) scores.

---

[2] Deloitte, *Motor Industry Services - 2016 Dealership Benchmarks,* p12 https://www.eprofitfocus.com/media/233268/052535_Motor-Industry-Services-Benchmark-2016_Cars_Final-Art.pdf.

4.8 On average, around 50 per cent of total dealer margin is now paid in the form of post-facto bonuses tied to a combination of key performance indicators but always with a heavy emphasis on CSI. This development over the last decade drives intense focus on customer satisfaction by franchised new car dealers. The Australian automotive value chain is undergoing structural change and business model disruption for a myriad of reasons including:

- cessation of motor vehicle manufacturing in Australia in 2017;
- technological disruption including ubiquitous connectivity and digitalisation;
- information and communication technology (ICT) companies entering the market;
- online dealership models;
- customer data/big data;
- automated, electric/hybrid vehicles and downsizing of internal combustion engines (ICEs);
- car concierge services;
- customer purchase journey; and
- regulatory intervention affecting revenue streams.

5. Budget context

5.1 The preparation of the Budget should carefully consider the structural changes occurring in the automotive value change with the cessation of manufacturing, lack of taxation reform, and regulatory intervention all of which will affect the sustainability of dealership operations particularly in regional areas.

6*. Cessation of motor vehicle manufacturing*

6.1 The cessation of motor vehicle manufacturing in Australia at the end of 2017 will have significant unemployment consequences in the automotive value chain and increases the importance of a vital and profitable franchised new retail industry for regional employment and economic growth.

6.2 Proposed amendments to the *Motor Vehicle Standards Act 1989* will mean that from 2018 Australian citizens (individuals) will be able to personally import a new passenger car from a country that has comparable standards to Australia limited to one vehicle in any 24 month period. The Department of Infrastructure and Regional Development (DIRD) has estimated that around 30,000 vehicles per year will be imported under this scheme.

6.3 If adopted in its present form, the proposed amendments have the potential to affect new vehicle sales in our members' businesses reducing overall revenue and impacting the goodwill of their businesses. Reduced vehicle through-put will also produce a negative knock-on effect on revenue streams on other revenue centres in a dealership operation.

6.4 The concern AADA has is the lack of modelling conducted by the DIRD on the financial impact on franchised dealership operations and subsequent reduction in revenue. Government taxes and charges comprise approximately 20 per cent of the price of any new vehicle, are cumulative and include:

- Import duty;
- GST – 10 per cent;
- LCT (if applicable);
- Stamp duty - ranging from 2 per cent to 4 per cent depending on State;
- Registration - approximately 2 per cent; and
- CTP- approximately 2 per cent.

6.5 While the DIRD has estimated that 30,000 vehicles per year are likely to be imported it has failed to acknowledge licence syndication risk which is readily susceptible to manipulation by import consolidators and opportunistic rent seekers. This suggests that the actual annual impact on franchised new car dealers would exceed the estimated 30,000 units. This could trigger the creation of a theoretic pool of at least several hundred thousand individual import licences, will be difficult to monitor, affect the sustainability of dealership operations and will be open to price manipulation to reduce Government charges and taxes.

7. Taxation reform

7.1 In our earlier submission to the Treasury on the tax reform discussion paper *Better Tax* we outlined the need for tax reform against accepted principles of tax evaluation and design:

- equity;
- efficiency;
- simplicity;
- sustainability; and
- policy consistency.

7.2 In MYEFO 2016-17 we note the estimates of taxation revenue from the automotive industry directly attributable to passenger motor vehicles as follows:

- luxury car tax - $630 million; and
- customs duty - $500 million.

7.3 Excise and customs duty on petrol, diesel and other fuel products amounted to $18100 million of which a significant proportion could be attributable to the automotive value chain. Our analysis of 20 per cent above did not include an amount for Government excise on fuel.

7.4 The Government's taxation receipts from motor vehicles also includes the luxury car tax (LCT). With the cessation of motor vehicle manufacturing in Australia at the end of 2017 we cannot see any logical justification for the retention of the tax. That aside, the Government's decision to allow personal imports does not appear to have addressed the collection mechanism and the possibility of price manipulation to reduce or avoid the LCT.

7.5 AADA's position with regard to the abolition of the LCT has been consistent and we have reproduced below extracts from AADA's submission to the Government's Tax White Paper released on 30 March 2015.

8. *Luxury car tax*

8.1 The LCT was introduced from 1 July 2000 as part of the GST tax reform package which saw the abolition of wholesale sales tax (WST). Under the WST luxury cars were taxed at a high rate together with other consumer goods such as furs, jewellery and electronics. These other goods became subject to the GST (10%) while luxury cars became subject to the GST and LCT at the then rate of 25 per cent. The Rudd government increased the rate to 33 per cent in 2008.

8.2 LCT applies at to cars sold or imported into Australia where the value of the car exceeds a GST-inclusive threshold. Some cars are exempt from tax including non-passenger commercial vehicles, most second hand cars, motor homes, campervans and emergency vehicles. The LCT rate of 33 per cent applies to the GST-exclusive value of the car (including accessories) above the LCT threshold. For the 2016-17 financial year the threshold is $64,132 for regular cars and $75,526 for fuel efficient vehicle. Revenue for 2016-17 is estimated to be $630 million.

9*. Policy rationale for retention no longer relevant*

9.1 The explanatory memorandum accompanying the bill introducing the LCT and replacing the 45 per cent WST on luxury vehicles stated "[it] will ensure that, following the introduction of the goods and services tax (GST), the value of luxury cars will fall in price as the same amount as a car just below the luxury car threshold." (LCT threshold for 1998-1999 was $55,134).

9.2 The Senate Standing Committee on Economics examined the bill in 2008 and noted the original 1986 WST “appears to have been a protectionist measure, designed to increase the price of European imports, while the 2000 LCT was introduced to ensure the introduction of GST did not result in a sudden reduction in the price of luxury vehicles, apparently because this might erode support for the GST”. Moreover, VACC in its submission to the committee noted “The European Union, and some importers have criticised the LCT as a disguised form of protection for the Australian car industry. According to the European Commission, 90 per cent of vehicles subject to the LCT are imported and 50 per cent are from Europe.”

9.3 Australia’s LCT is unique in the global tax landscape, penalises a consumer on a discretionary conspicuous purchase of a motor vehicle, does not apply to other “luxury” goods, and continues to exist on the statute books and Budget line as a major source of Commonwealth revenue despite the Henry Tax Review recommendation that it be abolished. With the impending cessation of motor vehicle manufacturing in Australia by the end of 2017 the LCT is an enigma and is completely at odds with Australia’s trade liberalisation policies including Free Trade Agreements to remove barriers to trade for imports. The LCT has often been referred as a thinly disguised tariff barrier.

9.4 The tax policy objective of the LCT no longer exists, it targets a single good, and is an additional tax borne by a consumer on a “luxury” car. If the Government’s policy objective is to tax luxury items, then a luxury tax should be imposed on other items including antiques, paintings, yachts, furs, jewellery including diamonds and watches, aircraft, holiday homes and luxury homes.

10. *Tax principles assessment of LCT*

10.1 A review of a tax should be conducted against accepted principles of tax evaluation and design:

- equity;
- efficiency;
- simplicity;
- sustainability; and
- policy consistency.

10.2 There is no definition of *equity* but a characteristic of a tax is that it should be fair in the distribution of the tax burden. The Henry Tax Review noted that taxes on luxury goods violate the principle of horizontal equity and wealthy people with modest tastes pay less than wealthy people with a preference for luxury goods. The LCT is selective and falls on people with a preference for more expensive cars but not on those with a preference for other items such as private yachts, antique clocks, diamonds and paintings.

10.3 In AADA's view the LCT could also be considered as taxation by stealth on those considered "wealthy" or on conspicuous consumption.

10.4 The Henry tax review also identified the flaw of luxury taxes when considering vertical equity. The review noted very few luxury goods are the preserve of the wealthy as the LCT is imposed on people of average means who have a preference for relatively expensive cars and as an example pointed out that many people feel a small sports car is luxurious at $60,000 but a 7 seater minivan is not luxurious at the same price.

10.5 It is also important to note that the Financial Crime Section of the Attorney-General's Department is examining options for regulating high-value dealers (HVDs) under Australia's anti-money laundering and counter-terrorism financing regime. They consider a high-value good to include jewellery, antiques and collectibles, fine art, yachts and luxury motor vehicles. We again question the rationale for only imposing a tax on what is considered to be a luxury motor vehicle.

10.6 *Efficiency* in the tax discussion paper is the economy in tax collection so as to have the lowest possible cost over and above the revenue raised. At the time of introduction of the LCT forecast administrative costs to the ATO were estimated at $1.45 million per year compared to revenue of $210 million in 2002-03. This does not include the administrative burden on businesses.

10.7 *Simplicity* means that the tax is easy to understand and simple to comply with relative to other taxes. Recent tax decisions in the Federal court have highlighted the complexity of administration of GST and LCT in determining the cost of a motor vehicle, and determination and timing of GST liability.

10.8 The Henry tax review referred to *sustainability* of a tax system as having the flexibility to allow the Government to respond to changing revenue needs, and *consistency* of the tax and transfer system to raise revenue and provide assistance to those in need.

10.9 The policy objective the Government sought to achieve with the introduction of the LCT has well and truly passed its use by date and in terms of principles the Henry tax review stated:

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

11*. Trade liberalisation*

11.1 An additional “luxury” tax paid by a consumer on an imported motor vehicle is at odds with Australia’s trade liberalisation policies. AADA submits the LCT as a thinly disguised tariff has no further role as a tax policy instrument in protecting the local manufacturing of motor vehicles which is to cease in 2017.

12. *LCT thresholds*

12.1 AADA submits the Government could consider transition arrangements to abolish the LCT to coincide with the cessation of manufacturing in 2017. This could include raising the LCT thresholds to a figure in excess of $100,000 where the price inelasticity of demand is close to zero.

13. Financial Impact of Regulatory Intervention

13.1 There are a number of concurrent regulatory matters which could have a significant effect on franchised dealership revenue streams. The combined impact of these measures, if implemented, has the potential to reduce the viability of franchised new car businesses and affect Budget revenue forecasts.

13.2 ASIC is presently considering the introduction of a regulation to mandate reductions in commissions to dealerships from the sale of finance contracts to customers. Economic modelling by accounting firm BDO shows that, depending on the final cap imposed, the regulation has the potential to reduce franchise dealership incomes by between $750 million and $1000 million annually.

13.3 The latter figure is about equal to the entire new car retail’s industry’s profits last year.

13.4 The ACCC is presently considering an application from the Insurance Council of Australia to engage in cartel behaviour to limit new car dealer commissions on the sale of add-on insurance products to 20 per cent of the premium, without a guaranteed concomitant reduction in the premium paid by consumers. Independent modelling by BDO indicates that there could a reduction in dealership income in the order of $200 million.

14. Conclusion

14.1 We would be happy to meet with you to discuss our submission and matters raised in our submissions to ASIC and the ACCC. Please do not hesitate to contact me on mobile 0413 007 833, email dblackhall@aada.asn.au or our Policy Director Michael Deed on mobile 0417 742 956, email mdeed@aada.asn.au

Yours sincerely

David Blackhall
Chief Executive Officer