

9: Indirect taxes

Overview

This chapter provides an overview of indirect taxes levied on specific goods and services, including fuel taxes, alcohol taxes, tobacco tax, the Luxury Car Tax, agricultural levies and tariffs. This chapter also discusses financial transaction taxes, corrective taxes and user charging.

Key points

- Indirect taxes on specific goods and services can be an efficient way to raise revenue. However, an ad hoc approach has contributed to a range of complexities and inconsistencies.
- Fuel taxes are the largest source of revenue on a specific good or service.
- The taxation of alcohol has two separate regimes, applying a value based tax for wine products and a volume based excise tax for other alcoholic beverages, with 16 different excise categories.
- The Luxury Car Tax has a narrow tax base, is complex and is the Australian Government's only luxury tax on a specific good or service.

9.1: Indirect taxes

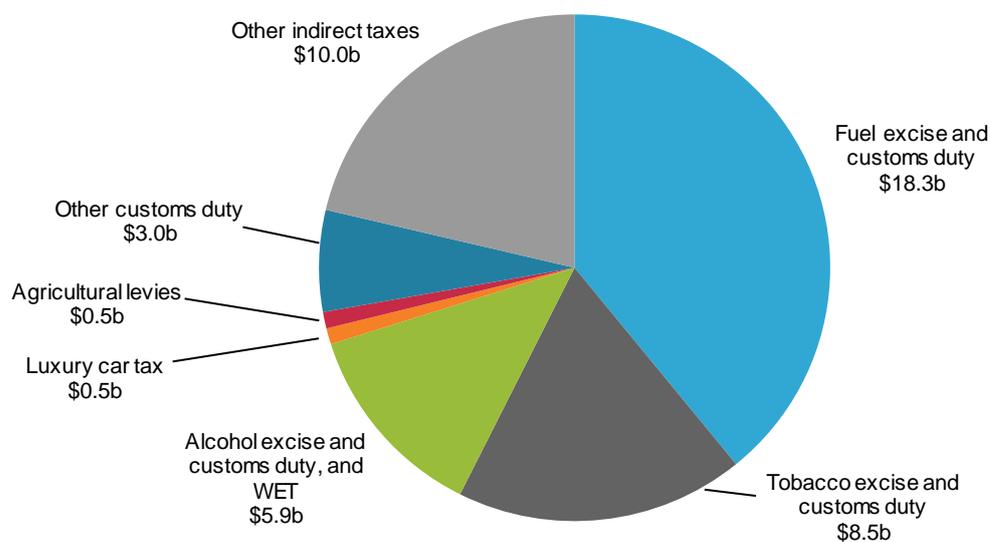
In addition to the GST, which the Australian Government collects on behalf of state and territory governments, the Australian Government collects a range of other indirect taxes. While the GST operates as a broad-based tax, these other indirect taxes are levied on specific goods and services. This chapter considers the main Australian Government specific indirect taxes including fuel taxes, alcohol taxes, tobacco tax, the Luxury Car Tax, agricultural levies and tariffs.

The rate and method of tax imposed on these specific goods and services varies, which reflects a diverse range of policy rationales underpinning the different indirect taxes. Traditionally, some indirect taxes have had a dual purpose of revenue generation and achieving desired behavioural changes.

Indirect taxes can be an efficient way to raise revenue. If taxes are imposed on goods or services where demand is less responsive to price changes, then they have a relatively small distortionary impact on behaviour. In this regard, modelling undertaken for Australia’s Future Tax System Review found fuel taxes have a relatively low marginal welfare loss compared to other taxes.²⁰²

Indirect taxes, other than the GST, raised \$47 billion in 2013-14, or 13 per cent of total Australian Government taxation revenue. Of this \$47 billion, \$33 billion came from fuel taxes, alcohol taxes and tobacco tax. The \$47 billion includes \$7 billion from the carbon tax that the government has since abolished.²⁰³

Chart 9.1 Australian indirect tax revenue, 2013-14



Note: Excludes the GST. Other indirect taxes include the passenger movement charge, broadcasting license fees, the carbon pricing mechanism and a range of other levies, penalties and charges.
 Source: Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, Canberra.

9.2: Fuel taxes

Fuel taxes (that is, excise and excise-equivalent customs duty) apply to fuels used in Australia. Fuel taxes raise the most revenue of the taxes levied on goods and services by the Australian Government with the exception of GST (Chart 9.1). Fuel taxes raised \$18.3 billion in tax revenue in 2013-14.²⁰⁴

Products subject to fuel taxes include petrol, diesel, certain oils and lubricants, and stabilised crude petroleum oil.

202 Australian Government 2010, *Australia’s Future Tax System Review (Henry Tax Review)*, Australian Government, Canberra, page 13.

203 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, page 9.

204 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government.

From February 2015, the rate of fuel tax that applies to petrol and diesel is 38.9 cents per litre. In contrast, alternative fuels (liquefied petroleum gas, compressed natural gas, liquefied natural gas, and domestically produced ethanol and biodiesel) are, or will be, taxed at a rate based on the energy content of these fuels in comparison to petrol and diesel, and then discounted by 50 per cent.²⁰⁵ This discount reflects the potential supplementary benefits provided by these fuels.

Fuel tax credits (FTCs) are provided to businesses that use fuel in their business for off-road activities (and partially for on-road activities where the vehicle exceeds 4.5 tonnes) to remove the incidence of fuel tax. FTCs give effect to the policy objective of ensuring that fuel tax on business inputs is minimised. This approach avoids distorting business investment decisions and behaviour that would occur by taxing business inputs. FTCs were worth \$5.7 billion in 2013-14.²⁰⁶ While the mining industry is the largest recipient of FTCs, other industries combined receive more than 60 per cent of the total value of FTCs. These other industries include transport, postal and warehousing; agriculture forestry and fishing; professional, scientific and technical services; construction; and manufacturing.²⁰⁷

9.3: Alcohol taxes

The taxation of alcohol is complex, with rates of taxation varying considerably for different types of alcoholic beverages. This reflects policy changes over time to meet multiple objectives — raising revenue, reducing the social costs of excessive alcohol consumption, and supporting wine producers and independent beer producers. Evidence suggests consumers are likely to change the amount of different types of alcohol they consume based on relative price changes of different alcoholic products.²⁰⁸ Chart 9.2 shows the difference in the amount of taxation of different alcoholic products.

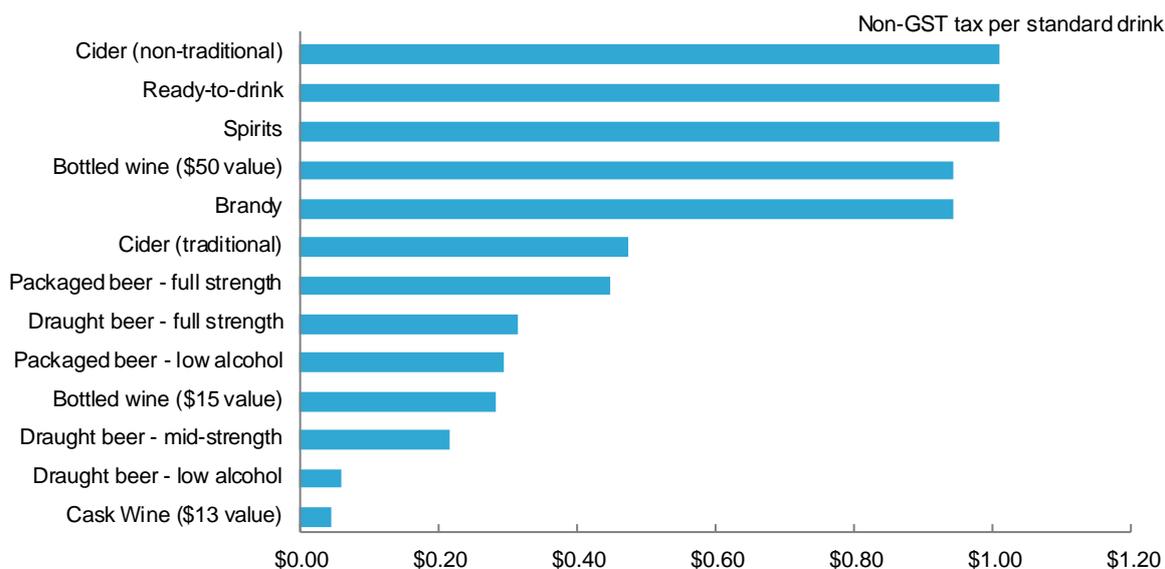
205 Imported ethanol and biodiesel will be taxed at 38.6 cents per litre, as noted in Australian Government 2014, *2014-15 Budget*, Australian Government, Canberra.

206 Australian Taxation Office (ATO) 2014, *Commissioner of Taxation Annual Report 2013-14*, ATO, Canberra.

207 Australian Taxation Office (ATO) 2014, *Excise and Fuel schemes: Fuel tax credits scheme — claims paid, by fine industry, 2006-07 to 2012-13 financial years*, Taxation Statistics 2011-12, ATO, Canberra.

208 Clark, J and Hollis, A 2013, 'Tax-to-GDP: Past and Prospective Developments', *Economic Roundup*, Issue 2, 2013, pages 29-30.

Chart 9.2 Alcohol tax paid per standard drink, August 2014



Source: Treasury estimates.

Most alcoholic beverages are subject to excise or excise-equivalent customs duty at one of 16 different excise categories depending on alcohol type, concentration, commercial use, and container size. Wine and some other alcohol products, such as traditional cider, are treated separately and subject to the Wine Equalisation Tax (WET). The WET was introduced as part of the GST tax reform package with the intent of equalising the amount of tax on wine, in particular cask wine, with that which existed under the wholesale sales tax system.²⁰⁹ While alcohol excise is based on the alcohol content, WET is generally based on the wholesale price of the wine. WET applies at 29 per cent of the value of the wine at the last wholesale transaction, before adding GST. In some cases, it can be difficult to determine if a product is subject to excise or WET (see box 9.1 'Tax Treatment of Ginger Beer'). Differences in the rate of tax can also create incentives to engineer products to receive the more favourable tax treatment.

In 2013-14, excise and excise-equivalent customs duty on beer, spirits and other excisable beverages raised \$5.1 billion in tax revenue. WET revenue amounted to \$826 million in 2013-14, net of producer rebates, which are typically around 25 per cent of total WET.²¹⁰

There are two tax concession schemes for producers of alcoholic beverages. The brewery refund scheme provides eligible independent breweries with a refund up to a maximum of \$30,000 per financial year, while the WET producer rebate provides eligible wine producers with a rebate up to a maximum of \$500,000 per financial year, regardless of whether they are independent or not. The significant variations in concessions, in conjunction with the favourable tax treatment afforded to specific types of alcohol, particularly low-value wine, can influence production and consumption decisions.

209 Australian Government 1998, *Tax reform: Not a new tax, a new tax system*, Australian Government, Canberra.

210 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, Canberra; and ATO 2013, *Taxation Statistics 2011-12*, ATO, Canberra.

Box 9.1 Tax treatment of ginger beer

The tax treatment of ginger beer demonstrates the inconsistencies in the current tax arrangements for alcohol, with the tax treatment dependent on alcohol content.

For example, a ginger beer with 4.5 per cent alcohol by volume is taxed as a 'ready to drink' (RTD) at a rate of \$1.01 per standard drink. The tax payable on a case of twelve 500ml bottles is \$21.54 under the excise regime.

However, a ginger beer that is nearly identical except that it has 8 per cent or more alcohol by volume is, instead, taxed on its wholesale selling price because it is characterised as a fruit or vegetable wine and subject to the WET regime. At a wholesale price of \$30, the tax payable on a case of twelve 500ml bottles is \$8.70 under the WET regime. The producer may also be able to claim the wine producer rebate.

This shows the significantly lower rate of taxation that can apply to beverages subject to taxation under the WET regime, despite the beverage containing more alcohol.

Internationally, beer, wine and spirits are typically taxed at different rates. There is a range of approaches to alcohol taxation across the OECD countries. Within the European Union, countries tax wine on a per litre of product basis, and beer and spirits based on the percentage of alcohol. In the United States, wine and beer are taxed on a per litre of product basis, and spirits are taxed based on the proportion of absolute alcohol. In both Chile and Mexico, there is a consistent taxation approach of charging a percentage of the value of alcohol on all alcohol products.²¹¹

9.4: Tobacco tax

Taxes on tobacco are the second largest, in terms of revenue raised, of the indirect taxes (excluding GST) raised by the Australian Government. Tobacco taxes raised \$8.5 billion in 2013-14.²¹² Should rates of smoking continue to decline, this could result in tobacco taxes making up a smaller share of taxes over the long term.

Tobacco is subject to excise and excise-equivalent customs duty. Cigarettes and cigars with up to 0.8 grams of tobacco per stick are taxed on a per stick basis. As at March 2015, the per stick excise and excise-equivalent duty is \$0.47008 or \$11.75 on a pack of 25 cigarettes. All other tobacco products, such as snuff and rolling tobacco, are subject to an excise and excise-equivalent custom duty rate of \$587.62 per kilogram. Rates are indexed twice a year in line with average weekly ordinary time earnings.

211 OECD 2012, *Consumption Tax Trends 2012L VAT/GST and Excise Rates, Trends and Administration Issues*, OECD, Paris.

212 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, Canberra, page 5.

9.5: Luxury Car Tax

Like the WET, the Luxury Car Tax (LCT) was introduced as a part of the GST tax reform package. The LCT has a narrow tax base, is complex and is the Australian Government's only luxury tax on a specific good or service.

Before the introduction of the GST, items such as expensive cars, furs, jewellery and electronics were all subject to a higher rate of wholesale sales tax. Since 1979, luxury cars had been subject to a wholesale sales tax of 45 per cent. Following the introduction of the GST and the abolition of the wholesale sales tax regime, the LCT was introduced at a rate of 25 per cent of the GST-exclusive value of the car to maintain the higher rate of taxation. The aim of this tax was to ensure that the price of luxury cars did not fall dramatically.²¹³ The LCT applies to a range of vehicles including passenger cars, station wagons, four-wheel drives and limousines.

Currently, the LCT applies to cars sold in or imported into Australia, with some limited exemptions, where the value of a car exceeds a GST-inclusive threshold. The LCT is currently applied at a rate of 33 per cent to the GST-exclusive value of the car (including accessories) when it exceeds the LCT threshold. For the 2014-15 financial year, the threshold is \$61,884 for regular cars and \$75,375 for fuel efficient vehicles. The LCT raised \$476 million in 2013-14.²¹⁴

In the past, it has been noted that the LCT's thresholds may not be an accurate representation of luxury in the car market — for example, a seven-seater family vehicle and a small sports car may both attract similar amounts of LCT.

Changes to the LCT have increased the tax's complexity over time. For instance, the two thresholds are now indexed to different price indices; the thresholds are no longer aligned with the 'car (depreciation) limit'; some industries and vehicle types are eligible for exemptions; and the LCT's interaction with the GST has become more complex.

Some stakeholders have raised concerns that the LCT falls mainly on imported cars originating from a limited number of jurisdictions and is therefore a barrier to trade. However, the LCT applies to all cars purchased in Australia, regardless of where the car is manufactured and therefore does not discriminate against imports.

Whilst the LCT does not discriminate between domestic and foreign manufactured vehicles, the majority of LCT revenue is derived from imported vehicles. Industry estimates indicate that in 2014 around 94 per cent of vehicles subject to LCT were imported. This has increased from around 89 per cent in 2005.²¹⁵

213 Australian Government 1998, *Tax Reform: Not a New Tax, A New Tax System — the Howard Government's Plan for a New Tax System*, Australian Government, Canberra.

214 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, Canberra.

215 Federal Chamber of Automotive Industries 2014, *VFACTS Data*, Federal Chamber of Automotive Industries, Canberra.

9.6: Agricultural levies

The Australian Government collects agricultural levies under its taxation powers at the request of primary producer associations. The purpose of the levies is to provide a significant, reliable and ongoing source of pooled funds for research, development and marketing of particular agricultural commodities. Levies are considered minor taxes due to the narrow base on which they are applied (usually per unit of commodity), and the relatively small amount of revenue generated by each individual levy. According to the Department of Agriculture, there are 97 primary industry levies imposed on 73 agricultural commodities with 18 recipient bodies.²¹⁶

Levies are imposed on individual producers of agricultural products. The Department of Agriculture collects the levy funds and passes them to the relevant Rural Research and Development Corporations and marketing bodies, as well as to Animal Health Australia, Plant Health Australia and the National Residue Survey, to fund activities that benefit levy-paying industries. The introduction of a new levy or a change in a levy requires support from a majority of the levy payers. Bodies that receive levies to conduct research, product development and marketing are accountable to levy payers and to the Government. Agricultural research and development corporations receive levy funds supplemented by Government matching up to a cap of 0.5 per cent of the industry's gross value of production.²¹⁷

Primary industry levies may be justified in theory where they address an identified potential market failure. When used effectively, they can assist producers to pool their efforts and resources, enabling greater levels of investment in activities that may otherwise be undersupplied as, due to the free-rider problem,²¹⁸ producers do not have the same incentive to invest when acting individually as they do when acting collectively.

Government support in the form of matching funds for research and development is provided on the expectation that the combination of the anticipated benefits for an industry and any positive spillovers outweigh the total costs. Levies are not the complete solution to address under-investment in rural research and development as they are unlikely to facilitate investment in research where the benefits are spread thinly across a wide range of industries or mainly accrue to the wider community.

216 Information provided by the Department of Agriculture.

217 Productivity Commission 2011, *Rural Research and Development Corporations*, final inquiry report no. 52, Productivity Commission, Canberra.

218 In this context, the free-rider problem refers to a situation where some producers would be able to receive the benefits of investment by other producers without having to make any investment themselves.

9.7: Tariffs

Tariffs are taxes applied to goods imported into Australia. In 2013-14, revenue from 'other customs duty' was \$3.0 billion.²¹⁹ Tariffs are usually imposed in order to protect domestic industries, rather than to raise revenue. In general, zero tariffs are expected to lead to higher living standards, regardless of tariffs imposed on Australian goods exported to other countries.

All import tariffs, except for those applying to textiles and motor vehicles and components, were progressively reduced from up to 19 per cent in 1988 to five per cent in 1996. Tariffs on motor vehicles and components were reduced from 45 per cent to five per cent between 1988 and 2010. For textiles, clothing and footwear, tariffs are being reduced from up to 89 per cent in 1988 to five per cent in 2015.²²⁰

As tariff revenue declines, the cost of collecting tariffs is increasing as a proportion of revenue raised. Tariffs raise costs for all businesses. The Productivity Commission estimates that, in 2012-13, Australia's tariff system imposed an aggregate cost on Australian businesses of \$7.1 billion by increasing the price of imported inputs and allowing domestic businesses to charge higher prices than they otherwise could.²²¹ This cost is ultimately passed on to domestic consumers.

The general tariff rate in Australia is five per cent and, prior to the commencement of the Korea Free Trade Agreement and the Japan Economic Partnership Agreement, applied to around 53 per cent of imports by value.²²² A Tariff Concession Scheme provides exemptions on application for imports for which no locally made substitute exists. Other tariff concessions also exist. Most goods imported from countries with which Australia has a free trade agreement attract no tariff, with the exception of certain automotive, steel and textile goods where the agreements provide for phased elimination.

Determining the tariff payable on imported goods, establishing whether any exemptions apply or proving that the goods meet the requirements for being eligible under free trade agreements can impose a significant compliance burden on some importers, a cost that is also passed on to consumers. However, some level of compliance is necessary for government data collection and law enforcement purposes.

219 Australian Government 2014, *2013-14 Final Budget Outcome*, Australian Government, Canberra, Table 4, page 9. Note: this figure does not include tariffs applied to imported fuel, tobacco or alcohol as Table 4 aggregates excise and tariff revenue for these items.

220 Centre for International Economics 2009, *Benefits of trade and trade liberalisation*, Centre for International Economics, Canberra. Note: historical tariff rates for textiles, clothing and footwear include the effect of import quotas; *Customs Tariff Act 1995*.

221 Productivity Commission 2014, *Trade & Assistance Review 2012-13, Annual Report Series*, Productivity Commission, Canberra.

222 Information supplied by the Department of Foreign Affairs and Trade.

9.8: Financial transaction taxes

As the name suggests, transaction taxes are imposed on prescribed transactions, and are generally determined as a proportion of the value of the transaction. Examples of transaction taxes in Australia include stamp duties on property and insurance taxes levied by state and territory governments (see chapter 8).

Financial transaction taxes (FTTs) impose a tax on transactions levied on a broad range of financial trading instruments, such as stocks, fixed income securities, derivatives and foreign exchange — the latter more popularly known as a Tobin tax.

The arguments against FTTs are similar to those against other stamp duties — taxes on FTTs add to the costs of buying and selling financial products and, as a result, can distort decisions about mutually beneficial transactions. Rather than being based on economic grounds, the revenue intake is a function of how often transactions take place, and those that frequently engage in transactions will be taxed more heavily even if they are in a similar position to other taxpayers. In addition, the Australia's Future Tax System Review (Henry Tax Review) concluded that FTTs can increase, rather than decrease, financial instability.²²³ This is because hedging activity (that is, transactions to disperse risk) could be impeded, or market liquidity could be reduced, resulting in prices becoming more volatile.

9.9: 'Corrective' taxes

Some taxes are introduced not as a means to collect revenue, but as a way to change behaviour. These are called corrective taxes. They are sometimes used instead of, or in addition to, information provision, regulation or fiscal measures, as a way of encouraging behaviour deemed socially desirable.

Using economic terms, corrective taxes might be imposed when a particular activity by an individual generates negative externalities for other people. Corrective taxes add to the costs of the activity borne by the individual — they aim to 'internalise' the costs of the wider harm caused by their activity.

Corrective taxes are usually advocated as a response to environmental or social concerns. In Australia, tobacco, alcohol and some motor vehicle taxes (such as annual vehicle registration fees) have some features of corrective taxes. Other corrective taxes used around the world include taxes on sugary drinks (to reduce obesity) and taxes on driving in specific areas or times (to reduce congestion).

²²³ Australian Government 2010, *Australia's Future Tax System Review (Henry Tax Review)*, Australian Government, Canberra.

9.10: User charges

User charges can also be used instead of taxes to fund the provision of services. A user charge is not a tax. Instead, it is a fee for a good or service provided by government where the user receives a distinct benefit. To the extent that such charges are appropriate, they can lower the cost to society of providing services, give the community greater say over whether they wish to consume (and pay for) the services and more directly influence the standard of service provided. In this way, user charges can be a useful way to help balance supply and demand for publicly-provided services.

Cost-reflective road pricing (or user charging) has been supported as a means to promote efficient investment in road transport, improve congestion and reduce vehicle costs.²²⁴ The Productivity Commission in its inquiry into Public Infrastructure recommended that the Australian Government actively encourage state and territory governments to undertake pilot studies of user charging for light vehicles.²²⁵ The Government supported this recommendation in principle as a long-term reform option. However, it also noted that user charging for roads was a complex issue and that matters like equity, as well as technological and privacy implications, would also need to be considered.

Most recently, the Competition Policy Review Draft Report recommended governments introduce cost-reflective road pricing and work across jurisdictions to reduce indirect charges and taxes on road users, as direct pricing is introduced (Draft Recommendation 3).

Discussion questions:

54. To what extent does Australia have the appropriate mix of taxes on specific goods and services? What changes, if any, could improve this mix?
55. To what extent are the tax settings (i.e. the rates and bases and the administration) for each of these indirect taxes appropriate? What changes, if any, could be made to these indirect tax settings to make a better tax system to deliver taxes that are lower, simpler, fairer?

224 For example, see Australian Government 2010, *Australia's Future Tax System Review (Henry Tax Review)*, Australian Government, Canberra, page 374

225 Productivity Commission, 2014, *Public Infrastructure*, Report no. 71, Canberra.