

## THE FAST AND THE FURIOUS: EXPLORING THE LIMITS OF LAW AND ECONOMICS THROUGH A CAMPAIGN TO REPEAL THE LUXURY CAR TAX

KATHRYN JAMES\*

*The subject matter of taxation provides something of a quandary for law and economics: it simultaneously offers a field of scholarship in which analysts share an equally enthusiastic embrace of efficiency as an organising principle but, in doing so, demonstrates the insufficiency of efficiency alone as a normative (and empirical) criterion. This article explores this dilemma by focusing on a somewhat obscure and, as yet unsuccessful campaign to remove the Australian luxury car tax. The campaign selectively overplays the efficiency problems of the tax as narrow and distorting while downplaying or ignoring other theoretical and empirical evidence in favour of its fairness and efficiency. In doing so, it repeats many of the mistakes for which the law and economics movement has been criticised, and thereby offers some insight into the limitations of a law and economics approach to the analysis of tax laws.*

### I INTRODUCTION

Few subject matters of legal inquiry rival taxation in offering an embrace of efficiency as a central organising principle as enthusiastic as that of law and economics. Just as law and economics has come to be regarded as ‘the most important development in legal scholarship of the twentieth century’ since it rose to prominence in the 1960s,<sup>1</sup> efficiency has likewise risen to become the pre-eminent organising principle in tax policy reflecting the growing influence of (neoliberal)

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\* Senior Lecturer and Australian Research Council, Discovery Early Career Research Fellow, Melbourne Law School. This research was partially supported 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, Adam Reisner and Eunice Mak for their excellent research assistance and to Patrick Emerton. Thanks to the participants in the Melbourne Law School tax seminar series who gave valuable feedback on an earlier version of the article as well as to the anonymous reviewers whose feedback greatly improved the final version. All errors are my own.

1 Robert Cooter and Thomas Ulen, *Law and Economics* (Addison-Wesley, 3<sup>rd</sup> ed, 2000) 2; Alex Raskolnikov, ‘Accepting the Limits of Tax Law and Economics’ (2013) 98(3) *Cornell Law Review* 523, 561 <<https://doi.org/10.2139/ssrn.1990430>>.

economics in tax policy since the 1970s.<sup>2</sup> Taxation therefore offers a rich case study for an investigation into the strengths and weaknesses of law and economics and especially the organising principle of efficiency.

Part II of this article provides an overview of law and economics as it applies to taxation, including an examination of two fundamental critiques of the endeavour: first, the overplaying of efficiency in the economics component; and second, the downplaying of the law component as an institution that mediates economic goals.

Part III of the article explores these critiques through what might first appear an obscure and circuitous route, via an examination of a yet unsuccessful campaign by the car industry to remove Australia's only luxury sales tax: the luxury car tax ('LCT'). This single-staged sales tax is levied in addition to, but not inclusive of, Australia's primary sales tax: the Goods and Services Tax ('GST'). Australians purchase around 1 million new motor vehicles each year, with around 100,000 of these being luxury cars.<sup>3</sup> Recently, during the COVID-19 pandemic, sales of luxury cars reached record levels.<sup>4</sup>

The campaign against the LCT proceeds on the basis that the tax was introduced alongside the GST in 2000 to prevent the politically unpalatable sight of the sales tax on luxury cars falling from 45% under the previous wholesale sales tax ('WST') to 10% under the GST.<sup>5</sup> Ergo, with the GST now firmly established more than 20 years on, the LCT is an anachronism without justification that should be abolished. The calls to repeal the tax were boosted by the 2009 *Australia's Future Tax System Review Final Report* ('Henry Review') which recommended the repeal of the LCT on the basis that raising revenue from such a narrow base is both inefficient (being distortive) and unfair (arbitrarily penalising people of equivalent economic capacity based on their tastes).<sup>6</sup> Given that the *Henry Review* (and the campaign to repeal the LCT) makes an appeal to efficiency and rejects an appeal to fairness in a manner broadly consistent with law and economics, it offers an ideal case study of the way these arguments play out in tax policy.

Part IV then analyses the empirical merits of the LCT by first placing the tax in historical and comparative perspective to show that there has been a range of justifications for imposing a higher rate of taxation on luxury vehicles including some which remain relevant today. It then assesses the operational performance of the LCT in terms of revenue generated relative to administrative and compliance costs. Importantly, it brings law into the analysis by assessing the role of legal design, administration and adjudication in the performance of the LCT. The analysis demonstrates that, contrary to the criticisms and relative to its aims (to raise

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2 Raskolnikov (n 1) 524.

3 Australian National Audit Office, *Administration of the Luxury Car Tax* (Audit Report No 45 2010–11, 31 May 2011) 11 [1] ('*ANAO Report 2011*').

4 Shane Wright, 'No Recession for Those in the Market for a Luxury Car', *Sydney Morning Herald* (online, 20 April 2021) <<https://www.smh.com.au/politics/federal/no-recession-for-those-in-the-market-for-a-luxury-car-20210420-p57kuf.html>>.

5 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('*GST Act*'); *A New Tax System (Luxury Car Tax) Act 1999* (Cth) ('*LCT Act*').

6 Australia's Future Tax System Review Panel, *Australia's Future Tax System Part 2: Detailed Analysis* (Final Report, 23 December 2009) vol 2, 469, 475–6 ('*Henry Review Detailed Analysis*').

revenue from taxing the sale and importation of luxury cars), the LCT performs well – raising an appropriate amount of revenue from a small but growing base at appropriately low administrative and compliance costs.

Parts V and VI consider the implications of these findings for the central accounts of efficiency and fairness that feature in the campaign to repeal the LCT and which predominate in both law and economics and tax policy. These Parts firstly conclude that the efficiency objections to the LCT are overstated at both a normative and empirical level. Once appropriate account is taken of the role of law, administration and the existing constraints of the tax system, the LCT performs well (as a second-best policy option). Secondly, they conclude that in the absence of major system-wide tax reform, the LCT has an important role to play in redistribution because it operates not only as a supplement to the GST but also to the income tax as a way to better tax the economic capacity of those with greater ability to pay. The article finally concludes by examining why, contrary to the claims of law and economics, redistribution is an important goal in tax policy and why taxing the additional consumptive capacity of the rich is a valid (albeit imperfect) method to achieve that goal and to provide for fairness in taxation.

## II LAW AND ECONOMICS AND TAXATION

Law and economics is premised on three foundational assumptions: first, that ‘human beings are rational maximizers of their ... “self-interest”’ (be it expressed as utility or welfare or wealth-maximisation);<sup>7</sup> second, that ‘the objective of the legal system is (under the positive strand) or should be (under the normative strand) to maximize social welfare viewed as an aggregation of the welfare (utility) [or wealth] of each member of society’;<sup>8</sup> third, markets are the best way to maximise social welfare because they permit individuals to enter voluntary exchanges thus allowing resources to go to their most valuable use (as measured by whoever is willing to pay the highest price for that resource).<sup>9</sup> Because taxation generally entails some intervention in market-based transactions,<sup>10</sup> be it decisions to work, invest or spend, efficient in the context of a law and economics analysis of taxation means *non-distortive* (as interfering least with market outcomes) and therefore *neutral* is its natural corollary.<sup>11</sup>

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7 Richard A Posner, *Economic Analysis of Law* (Wolters Kluwer, 9<sup>th</sup> ed, 2014) §1.1. Posner adopts the narrower Kaldor-Hicks criterion of efficiency as wealth maximisation (an allocation of resources that produces more benefits than costs if in theory those who are made better off could compensate those who are made worse off) over Pareto optimal efficiency (an allocation of resources that makes at least one person better off and no one worse off) on the basis that ‘the conditions for Pareto superiority are rarely satisfied in the real world’: at §1.2.

8 Raskolnikov (n 1) 531.

9 Posner (n 7) §1.1.

10 For a challenge to the conventional divide between market (pre-tax) and post-tax outcomes, see Liam Murphy and Tom Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002) 74.

11 Raskolnikov (n 1) 528, 573.

Although all these assumptions are controversial and contestable, they are hardly surprising given their broad alignment with the neoliberal consensus that has dominated economics and tax policy analysis for the past half-century.<sup>12</sup> The primacy afforded to efficiency (in the narrow sense of non-distortionary) has been taken up with gusto in tax policy. Whereas the need to balance equity with efficiency once dominated tax discourse, efficiency has come to predominate.<sup>13</sup> This is evident in the language of the major institutions of influence in international tax policy, the Organisation for Economic Co-operation and Development ('OECD'), International Monetary Fund ('IMF'), and World Bank, and in the major discussions and reviews of tax reform within jurisdictions including the *Henry Review*. It is further evident in the content of reform proposals and trends whereby most prescriptions propose moving away from a comprehensive and progressive income tax base to one on labour income or consumption for reasons of efficiency (therefore alleviating the taxation of capital and corporate income).<sup>14</sup>

However, the privileging of efficiency as the pre-eminent goal of law and economics analyses of taxation is deeply problematic. Two criticisms are explored here: first, law and economics offers an incomplete theory of taxation because it privileges a narrow and flawed idea of efficiency that gives insufficient weight to redistribution and bears little resemblance to the real world; and second, inadequate account is made of the role of law in mediating or translating economic theory (including the economic ideal of efficiency) into tangible outcomes.

### A An Incomplete Theory – The Problems with Efficiency as a Guiding Principle

Heckman, a leading Chicago school economist, concludes that the 'failure to develop a satisfactory framework within which to analyze redistribution makes law

12 Ibid 531. For an overview of why these assumptions are controversial, see, eg, Patrick Emerton and Kathryn James, 'The Justice of the Tax Base and the Case for Income Tax' in Monica Bhandari (ed), *Philosophical Foundations of Tax Law* (Oxford University Press, 2017) 125.

13 For Canada's approach to taxation, see *Royal Commission on Taxation: Introduction, Acknowledgments and Minority Reports* (Report, 1966) vol 1, 1–6; Australia's Future Tax System Review Panel, *Australia's Future Tax System Part 1: Overview* (Final Report, 23 December 2009) ('*Henry Review Overview*') 15–21.

14 See, eg, Organisation for Economic Co-operation and Development, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2020) 12, 21–2 <<https://doi.org/10.1787/152def2d-en>> ('*OECD Consumption Tax Trends 2020*'); Z Shalizi, *Lessons of Tax Reform* (World Bank, 1991) 24 <<https://doi.org/10.1596/0-8213-1906-X>>; Philip R Gerson and Manmoham S Kumar, *Fiscal Monitor* (November 2010): *Fiscal Exit* (International Monetary Fund, 2010) 80 <<https://doi.org/10.5089/9781616350475.089>>; International Monetary Fund, *Fiscal Monitor: Fiscal Policy from Pandemic to War* (Report, April 2022) 29; John Norregaard and Tehmina S Khan, 'Tax Policy: Recent Trends and Coming Challenges' (Working Paper No 07/274, International Monetary Fund, 1 December 2007) 37–8 <<https://doi.org/10.5089/9781451868371.001>>; Liam Ebrill et al, *The Modern VAT* (International Monetary Fund, 2001) 17, 198 <<https://doi.org/10.5089/9781589060265.071>>; *Henry Review Overview* (n 13) 15–21. The authors of a leading Australian tax textbook repeat the general refrain, '[n]eutrality is another key aspect of efficiency; that is, the impact of tax should not *unintentionally* 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': Robin Woellner et al, *Australian Taxation Law* (CCH Australia, 31<sup>st</sup> ed, 2021) 569 [1-200] (emphasis in original).

and economics analytically incomplete'.<sup>15</sup> This is not to say that law and economics is unaware of how questions of distribution affect patterns of allocation. Posner, for example, acknowledges that 'the pattern of consumption and production is determined by the distribution of wealth' and so '[i]f that distribution is unjust, the pattern of economic activities derived from it will not have a strong claim to be regarded as just either'.<sup>16</sup> However, he sidesteps the issue by concluding that 'economics cannot tell us whether the existing distribution of income and wealth is good or bad, just or unjust'.<sup>17</sup> Yet fortuitously 'this turns out to be less of a handicap to the normative use of economics than might appear' because economists 'can usually appeal to a generally accepted goal, such as maximising the value of output, rather than having to defend the goal' so that 'they can make a normative statement without having to defend their fundamental premises'.<sup>18</sup>

This normative flippancy enables Posner to make a series of bold claims and prescriptions with little to no evidence in support beyond an appeal to efficiency (or non-distortion). So he resists calls for redistribution that are grounded in diminishing marginal utility (the principle that the loss of a dollar hurts the millionaire less than it benefits the pauper) on the basis that such calls depend on a fundamentally flawed interpersonal comparison of utilities and may in fact violate efficiency in maximising aggregate welfare because perhaps the billionaire might just value that extra dollar more than the pauper who needs it to eat.<sup>19</sup> He therefore warns that 'redistributing substantial wealth from higher-income to lower-income people [on the basis that it] is bound to increase total utility, would be perilous even on the unrealistic premise that redistribution is costless'.<sup>20</sup> He asserts that 'income equality is less important than total income in maintaining social peace and political stability' without offering a single example in support.<sup>21</sup> And although he does not necessarily subscribe to the disincentive effects of progressive income taxation, he shares Friedman's concern that such taxation might permit 'the electorate to shift the burden of taxation to a numerical minority, composed of people with high incomes'.<sup>22</sup>

However, the consequent prioritising of a normative goal (of wealth maximisation facilitated through market exchange) without having to defend it has generated much controversy.<sup>23</sup> Some query if efficiency or wealth maximisation even has normative content or is merely a means to an end.<sup>24</sup> Others query if the prioritisation of efficiency does in fact maximise welfare and point to the market

15 James J Heckman, 'The Intellectual Roots of the Law and Economics Movement' (1997) 15(2) *Law and History Review* 327, 332.

16 Posner (n 7) §1.2.

17 Ibid.

18 Ibid.

19 Ibid §18.11.

20 Ibid §17.2.

21 Ibid.

22 Ibid §18.11, citing Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962) 174–5.

23 For an overview, see David Driesen and Robin Paul Malloy, 'Critiques of Law and Economics' in Francesco Parisi (ed), *The Oxford Handbook on Law and Economics: Volume 1* (Oxford University Press, 2017) 300 <<https://doi.org/10.1093/oxfordhb/9780199684267.013.024>>.

24 Ronald Dworkin, 'Why Efficiency? A Response to Professors Calabresi and Posner' (1980) 8(3) *Hofstra Law Review* 563; Driesen and Malloy (n 23) 300–2.

failures (such as the global financial crisis) that result from an approach that simply lets markets run.<sup>25</sup> Others query whether economic growth might in fact be better achieved by a reasonably (or at least more) equal distribution of wealth (to enable individuals to better realise their potential).<sup>26</sup>

A recent critique of law and economics by scholars within the law and political economy movement dispute the elevation of certain economic concepts such as efficiency and neutrality as beyond critique. Such scholars contend that this encases the market from claims of justice and conceals the power dynamics at play.<sup>27</sup> Others criticise law and economics for giving an insufficient account of the complex normative issues involved in the choices around tax design which involve balancing value judgments that go to the heart of ‘what constitutes a just society, what citizens owe to each other, and what limitations on liberty are acceptable’.<sup>28</sup> These deeply contested normative issues must then be balanced against more immediate concerns such as: what should be the basis for redistribution (ability, benefits, talent); how should that be measured (income, wealth, consumption); and how might individuals respond to attempts to tax those measures including by doing more of it (the income effect), doing less or none of it or doing something different in its place (the substitution effect), or to engage in arbitrage to avoid the impost (regarded by many, but not all, as socially wasteful and a deadweight loss).<sup>29</sup>

25 Driesen and Malloy (n 23) 302; Joseph E Stiglitz, ‘Development-Oriented Tax Policy’ in Roger H Gordon (ed), *Taxation in Developing Countries: Six Case Studies and Policy Implications* (Columbia University Press, 2010) 11, 14.

26 Driesen and Malloy (n 23) 302; Jonathan D Ostry, Andrew Berg and Charalambos G Tsangarides, ‘Redistribution, Inequality, and Growth’ (Staff Discussion Note, International Monetary Fund, April 2014) 5 <<https://doi.org/10.5089/9781484352076.006>>; Federico Cingano, ‘Trends in Income Inequality and Its Impact on Economic Growth’ (Working Paper No 163, Organisation for Economic Co-operation and Development, 9 December 2014) 29 <<http://dx.doi.org/10.1787/5jxjncwvxv6j-en>>; United Nations Conference on Trade and Development, *Trade and Development Report, 2012* (Report, UN Doc UNCTAD/TDR/2012, May 2013) 118 <<https://doi.org/10.18356/3c7b4064-en>>.

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.

27 See, eg, Jedediah Britton-Purdy et al, ‘Building a Law-and-Political-Economy Framework: Beyond the Twentieth Century Synthesis’ (2020) 129(6) *Yale Law Journal* 1784, 1784; Jeremy Bearer-Friend et al, ‘Taxation and Law and Political Economy’ (2022) 83(3) *Ohio State Law Journal* 471.

28 Raskolnikov (n 1) 562.

29 ‘[T]ax evasion has a strong resemblance to theft. Evaders essentially steal from the government – that is, from all compliant taxpayers. The transfer costs related to tax evasion are real social losses, and they are likely to be substantial’: ibid 535. ‘Some responses to taxation can be deterred. *All* such responses never can be’: at 544 (emphasis in original); cf 558–60 (for opposing views). David A Weisbach, ‘Ten Truths about Tax Shelters’ (2002) 55(2) *Tax Law Review* 215, 222:

[T]ax planning, all tax planning, not just planning associated with traditional notions of shelters, produces nothing of value. Nothing is gained by finding new ways to turn ordinary income into capital gain, to push a gain offshore, or to generate losses ... Tax planning is actually far worse than that. It is almost always positively bad for society – it is worse than worthless.

For a parochial version of the debate on the wastefulness of tax minimisation, see, eg, Yuri FR Grbich and Mark M Leibler, ‘Should the Law Institute of Victoria Take a Public Stand against Artificial and Contrived Tax Avoidance Schemes: A Debate’ (1980) 54(9) *Law Institute Journal* 560, 560–2 (Yuri FR Grbich, the case for), 562–4 (Mark M Leibler, the case against).



However, perhaps the most devastating critique of law and economics comes from a source which might be considered a natural ally – optimal tax theory, arguably the leading normative approach to taxation within public finance for the past five decades.<sup>30</sup> As Diamond and Mirrlees famously demonstrated, if all we cared about was efficiency, then tax policy would be simple, consisting of a single uniform lump sum tax payable by everyone (and thus unable to be avoided).<sup>31</sup> However, because such a tax is unfair (imposing the same burden on the billionaire and the pauper alike) no system adopts it.<sup>32</sup> As a result, optimal tax theory attempts to reconcile the needs to raise revenue and redistribute by developing an optimal redistribution which achieves ‘a balance between the equity improvements and the efficiency losses from further taxation’.<sup>33</sup> Unlike Posner, optimal tax theory accepts the need to redistribute on the basis of diminishing marginal utility (the poor gain more utility from the transfer than the rich lose in the tax liability).<sup>34</sup> The optimal model income tax proposed by Diamond and Mirrlees is a tax on labour income only with a cash grant paid to all taxpayers and a schedule of constant or declining marginal rates.<sup>35</sup> Therefore, a tax that excludes capital income, corporate income and a tax on wealth (but that is progressive overall because average rates rise with income).<sup>36</sup> A discussion of optimal commodity taxation is in Part V.

This proposed model is itself subject to challenge, both from within and outside optimal tax theory. Criticisms include: the constrained and unrealistic assumptions that are necessary to make the model work but which bear little to no relation to reality;<sup>37</sup> or more recently, how shifting or challenging certain assumptions can produce different models which, for example, include capital income and incorporate progressive marginal rates.<sup>38</sup> Importantly, it reflects how a model focused on increasing overall utility/welfare offers an anaemic account of economic justice when compared to other models which focus on maximising

30 Joel Slemrod, ‘Optimal Taxation and Optimal Tax Systems’ (1990) 4(1) *Journal of Economic Perspectives* 157, 157 <<https://doi.org/10.1257/jep.4.1.157>>.

31 Peter A Diamond and James A Mirrlees, ‘Optimal Taxation and Public Production I: Production Efficiency’ (1971) 61(1) *American Economic Review* 8, 8 (‘Optimal Taxation and Public Production I’); N Gregory Mankiw, Matthew Weinzierl and Danny Yagan, ‘Optimal Taxation in Theory and Practice’ (2009) 23(4) *Journal of Economic Perspectives* 147, 149.

32 A non-uniform lump tax payable on the basis of innate characteristics of taxpayers is impossible to implement because characteristics such as earning ability are unobservable: Raskolnikov (n 1) 525; Diamond and Mirrlees, ‘Optimal Taxation and Public Production I’ (n 31) 9.

33 Diamond and Mirrlees, ‘Optimal Taxation and Public Production I’ (n 31) 9.

34 Raskolnikov (n 1) 541, 547.

35 Diamond and Mirrlees, ‘Optimal Taxation and Public Production I’ (n 31) 13; Peter A Diamond and James A Mirrlees, ‘Optimal Taxation and Public Production II: Tax Rules’ (1971) 61(3) *American Economic Review* 261, 269–70, 276–8 (‘Optimal Taxation and Public Production II’); JA Mirrlees, ‘An Exploration in the Theory of Optimum Income Taxation’ (1971) 38(2) *Review of Economic Studies* 175, 207–8; Raskolnikov (n 1) 546–7.

36 Raskolnikov (n 1) 547, 569.

37 Ibid 546, 571, 590.

38 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, 167–83; Thomas Piketty and Emmanuel Saez, ‘A Theory of Optimal Capital Taxation’ (Working Paper No 17989, National Bureau of Economic Research, April 2012).

human capabilities<sup>39</sup> or on securing a basic structure that emphasises the free equality of its citizens.<sup>40</sup> Nevertheless, even despite these limitations, optimal tax theory offers a far richer and more realistic account than that provided by law and economics because it treats the question of redistribution seriously. As Raskolnikov contends, the failure of law and economics to sufficiently address redistribution is amplified by the fact that most other areas of inquiry within law and economics defer to taxation to achieve redistribution.<sup>41</sup>

It is hard to overstate the influence of optimal tax theory given that it has provided the normative justification for much of the tax reforms of the past half-century, detailed at the beginning of this Part, such as the movement away from a comprehensive and progressive income tax and towards consumption taxes (considered equivalent in effect to a wage tax).<sup>42</sup> However, even despite this influence, few if any real-world tax systems bear close resemblance to the optimal model. Raskolnikov contends that this has serious implications for the law and economics endeavour because, in the absence of a workable and reliable baseline from which to measure efficiency in the real world, ‘any efficiency-based argument is at best a marginal claim and should be evaluated alongside all other possible marginal improvements’:

The argument that ‘the system’ reveals a preference for welfare maximization is completely implausible in tax. Even if a policymaker cares about efficiency, the second-best problems are so severe that taking steps that would bring us closer to the optimal regime may well be welfare reducing.<sup>43</sup>

In other words, when law and economics relies on an appeal to an ideal regime (such as competitive markets) such an appeal fails in taxation because the ideal (of the optimal tax model) is completely unable to offer guidance on key questions that go to the heart of designing a tax system. These questions are in and of their nature second-best because they concern features of the tax system that exist outside the optimal model, such as: how should we tax cross-border capital income, to what extent should we tax transfers of wealth and at what rate should we tax corporate income? A simple appeal to the goal of welfare-maximisation at best adds little to the analysis and at worst is counterproductive to the endeavour.<sup>44</sup>

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39 Martha Nussbaum and Amartya Sen (eds), *The Quality of Life* (Clarendon Press, 1993); Martha C Nussbaum, *Women and Human Development: The Capabilities Approach* (Cambridge University Press, 2000); Amartya Sen, *The Idea of Justice* (Belknap Press, 2009).

40 John Rawls, *A Theory of Justice* (Oxford University Press, rev ed, 1999) 52–73. For Rawls’ account of efficiency within this framework, see 59–65. For Posner’s response to Rawls which rests on a mischaracterisation of Rawls’ weighting of risk in the original position, see Posner (n 7) 644–6.

41 Raskolnikov (n 1) 545, 571.

42 See the recommendations of the *Australia’s Future Tax System Review Final Report* (‘Henry Review’) as an example: *Henry Review Overview* (n 13). Alvin Warren, ‘Would a Consumption Tax Be Fairer than an Income Tax?’ (1980) 89(6) *Yale Law Journal* 1081 <<https://doi.org/10.2307/796024>>.

43 Raskolnikov (n 1) 567 n 176, 568.

44 Ibid 567–70.



## B An Insufficient Account of the Mediating Role of Law

So far, we have only considered the second component of the law and economics endeavour. However, there are serious problems with the first which stem from an overemphasis on economics and an underemphasis on the independent and mediating role of law. As Driesen and Malloy contend, '[f]rom the outset, the economic analysis of law made law the subject of economic inquiry' which in turn 'privileged economics and the economic point of view over that of law'.<sup>45</sup> Some have responded by making an 'interpretive turn'<sup>46</sup> to evaluate economic criteria, assumptions and models from the perspective of law so that:

[O]ne no longer asks if a legal rule is efficient but rather if an efficiency criterion promotes justice and fairness in a given situation. One no longer thinks in terms of a well-functioning and efficient market as an end in itself, but in terms of the market as a means to advance important normative values [such as justice and fairness].<sup>47</sup>

The objection made in this article is a far less profound but nevertheless important one, which is that laws mediate economic concepts and translate them from ideas to action. A focus on reform which occurs purely at the level of economic policy fails to appreciate the constraints in a system that adheres to the rule of law whereby the implementation of any major policy idea requires parliament to pass legislation detailing those laws, administrators to administer them and judges to determine their limits guided by their own interpretive rules for doing so. This brings to bear a number of institutionalised influences that impact upon the realisation of that idea. A simple example is the legislation implementing the Australian GST. Few would doubt that the economic goal of the GST is to tax a base of final consumption. However, the GST legislation makes minimal reference to the economic concept of consumption, but rather attempts to give effect to the underlying legal transactions which give rise to expenditure on final consumption.<sup>48</sup> The High Court has made it clear that these legal terms are the proper subject of judicial interpretation, not the economic goal(s) they seek to achieve (of taxing consumption).<sup>49</sup> As a result, outcomes can be as much (if not more) a product of these institutions rather than the underlying logic of the economic idea.<sup>50</sup>

So where does this all lead us? Perhaps somewhat unexpectedly, it leads us to a campaign by the Australian car industry to repeal the LCT. The campaign offers an ideal case study to examine the promises and tensions in the law and economics approach to taxation because it offers an example of a second-best policy which is

45 Driesen and Malloy (n 23) 307 (emphasis omitted).

46 Ibid.

47 Ibid. For a fuller account of the reframing and reprioritisation of norms such as justice and equality alongside an acknowledgment of the role of political power in informing these normative concepts, see the work of scholars within the law and political economy movement referred to in n 27.

48 See, eg, *GST Act* (n 5) ch 2 (basic rules), s 195-1 (dictionary). The *GST Act* contains no express purpose clause.

49 See, eg, *Federal Commissioner of Taxation v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342, 346 [3] (Gleeson CJ, Gummow, Heydon, Crennan and Kiefel JJ).

50 For a more detailed exposition of the argument, see Kathryn James, 'Reconsidering the Case for Tax Reform during a Crisis' (2021) 47(2) *Monash Law Review* (forthcoming); Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 295–308.

susceptible to a law and economics critique but which, upon closer scrutiny, offers an example of a tax instrument that performs well even when measured against an efficiency criterion and particularly so against a redistributive one.

### III THE CAMPAIGN TO REPEAL THE LCT

Recent calls to remove the LCT proceed on the basis that, more than 20 years since its introduction, the tax is an anachronism without justification that should be abolished. This Part outlines the arguments against the LCT and provides some historical and comparative context for the tax before Part IV assesses its operation and performance.

Before proceeding further, it is important to detail an important caveat, which is that there are a number of taxes and charges that apply to motor vehicles. At the state level, this includes 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.<sup>51</sup> At the Commonwealth level, this includes the income tax generally and the fringe benefits tax ('FBT') specifically (being either income in kind and taxed under the FBT or a depreciable business expense for which deductions can be claimed) as well as various fuel excises and import tariffs.<sup>52</sup> 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 focus of this article is on the merits or otherwise of a dedicated sales tax on luxury cars as a case study for an evaluation of the limits of law and economics analysis of taxation. The merits of the overall tax treatment of cars and luxury vehicles including the important environmental considerations that might come into play is an endeavour for another day.<sup>53</sup>

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51 Victoria has progressive rates of stamp duty payable on vehicle value including higher rates for luxury vehicles (AUD100,001–150,000) and super-luxury vehicles (more than AUD150,000) effective from July 2019, and Queensland introduced a similar measure in 2018: 'Motor Vehicle Duty Current Rates', *State Revenue Office Victoria* (Web Page, 1 July 2022) <<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* (online, 17 June 2019) <<https://www.brisbanetimes.com.au/business/consumer-affairs/peak-car-dealer-body-plans-high-court-challenge-over-new-stamp-duties-20190616-p51y7p.html>>.

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

53 Prafula Pearce and Dale Pinto, 'An Evaluation of the Case for a Congestion Tax in Australia' (2015) 18(4) *Tax Specialist* 146, 151; 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) 23 ('*Senate Committee Report on Luxury Car Tax 2008*'). See below n 100.

### A A Consensus for Repeal

A review of the discussion in Australia of the LCT 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.<sup>54</sup>

A survey of media reports from 1998–2021 undertaken for this article found that the volume of articles written on the LCT has significantly increased since its introduction, as has opposition towards it.<sup>55</sup> These media reports and commentary are mostly dominated by car industry representatives who since 2008 (when the LCT rate increased) have intensified a concerted campaign to repeal the LCT.<sup>56</sup> Such is the overwhelming weight of opinion that this article uses the term ‘campaign’ rather than ‘debate’ (which implies at least two sides) to describe it. Commentators and industry representatives have variously described the tax as ‘unconscionable’,<sup>57</sup> ‘outdated, unjustifiable and unnecessary’.<sup>58</sup> A review of the academic literature reveals that scant attention has been paid to the LCT with very few analyses favourably disposed to it.<sup>59</sup> Two major tax reviews have expressed misgivings about the tax with the most prominent, the *Henry Review*, recommending its abolition in 2009.<sup>60</sup>

54 See, eg, Tony Weber, chief executive of the Federal Chamber of Automotive Industries, concluded 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’, *The Sydney Morning Herald* (online, 11 October 2019) <<https://www.smh.com.au/business/companies/european-car-makers-rev-up-push-against-luxury-car-tax-20191011-p52zpu.html>>.

55 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 luxury car tax (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 were broadly supportive. From 2010–21, a random sample of 52 articles found 46 articles critical of the tax, 4 articles that were neutral and only 2 in support.

56 See, eg, Gray (n 54); Nassim Khadem and Edmund Tadros, ‘End Tariffs and Luxury Car Tax: Industry’, *Australian Financial Review* (Sydney, 13 February 2014) 9; Toyota Australia, ‘Toyota Calls for Luxury Car Tax Abolition’ (Press Release, 21 June 2011); ‘Luxury Tax Attacked’, *The Cairns Post* (Cairns, 16 July 2011) 7 (effectively reproducing significant portions of the Toyota media release); Joshua Dowling, ‘Toyota Drivers Seeing Red over Tax’, *The Age* (Melbourne, 15 June 2019) 4; Fleur Anderson, ‘Toyota on Tax Starting Line’, *Australian Financial Review* (online, 22 June 2011) <<https://www.afr.com/policy/tax-and-super/toyota-on-tax-starting-line-20110622-icb2h>>; Andrew Tillet, ‘Motor Lobby Calls for Scrapping of “Redundant” Car Taxes’, *Australian Financial Review* (Melbourne, 19 February 2020) 9; Joshua Dowling, ‘Fresh Call to Pull Brakes on Tax’, *The Sydney Morning Herald* (Sydney, 15 June 2019) 8.

57 Richard Dudley, chief executive of the Motor Trades Association of Australia, quoted in Patrick Commins and Richard Ferguson, ‘Drop Car Tax, Treasurer Told’, *The Australian* (Sydney, 19 February 2020) 1.

58 Horst von Sanden, chief executive of Mercedes-Benz Australia/Pacific, quoted in Gray (n 54).

59 Despite finding that the LCT has not dampened demand and does generate revenue, McPherson et al repeat the standard economic critique of the LCT as a deadweight loss and conclude that the LCT is inefficient, distortive and should be repealed: see, eg, Andrew McPherson et al, ‘An Economic Analysis of the Luxury Car Tax in Australia’ (2011) 4(1) *Deakin Papers on International Business Economics* 17 <<https://doi.org/10.21153/dpibe2011vol4no1art181>>. Prafula Pearce, ‘The Luxury Car Tax: Past Its Use-By Date’ (2011) 47(11) *Taxation in Australia* 703; Pearce and Pinto (n 53) 151.

60 *Henry Review Detailed Analysis* (n 6) vol 2, 476 (‘Recommendation 80: The luxury car tax should be abolished’); Treasury, Australian Government, ‘Re:think: Tax Discussion Paper’ (Discussion Paper, March 2015) 157, 162. A Senate Committee review of a Labor government proposal to increase the rate

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 then Opposition leader, Anthony Albanese, declared, '[i]f 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.'<sup>61</sup>

Chief among the criticisms is that the LCT has outlived its original intent to secure support for the controversial GST reforms.<sup>62</sup> It was poor political optics to introduce the GST (considered regressive in effect because it places a higher relative burden on the poor, who spend all their income, than the rich, who both consume and save)<sup>63</sup> 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 follow the fate of that industry.<sup>64</sup> These claims are examined by placing the LCT in historical and comparative context before the substantive criticisms of the LCT are addressed at Part III(D).

## B An Anachronism? The LCT in Historical Context

Prior to the introduction of the GST in 2000, Australia imposed the WST which was a single stage sales tax operating under a system of graduated rates determined by the classification of goods into various schedules.

Since it was first introduced in 1930 to fund the revenue needs of a fisc constrained by the severe economic contraction of the Great Depression,<sup>65</sup> the WST was variously deployed as a regulatory tool of economic intervention which was facilitated by the adoption of a graduated rate structure from 1941. At times, high rates were imposed on certain goods during wartime to discourage the redirection

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of the LCT from 25% to 33% was split along party lines: *Senate Committee Report on Luxury Car Tax 2008* (n 53).

- 61 Phillip Coorey, 'The Politics of Axing the Luxury Car Tax', *Australian Financial Review* (online, 20 February 2020) <<https://www.afr.com/politics/federal/the-politics-of-axing-luxury-car-tax-20200219-p542fr>>. The then Minister for Trade, Tourism and Investment, Simon Birmingham, declared in a radio interview in 2019 that

[w]e 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 Simon Birmingham (Tom Elliot, Radio 3AW, 5 September 2019) <<https://www.trademinister.gov.au/minister/simon-birmingham/transcript/interview-3aw-drive-tom-elliott-0>>.

- 62 See, eg, Gray (n 54); Sid Maher, Andrew Fraser and Adam Creighton, 'Call to End Tariffs to Slash Prices', *The Australian* (12 February 2014) 1.
- 63 For a summary of the arguments, see, eg, James, *The Rise of the Value-Added Tax* (n 50) 32–5.
- 64 See, eg, Khadem and Tadros (n 56); Brian Marlow, 'Luxury Car Tax Failed to Save Holden' (Media Release, Australian Taxpayers' Alliance, 19 February 2020); Commings and Ferguson (n 57) 1.
- 65 See *Sales Tax Assessment Act (No 1) 1930* (Cth) enacted on 18 August 1930 and associated Acts.

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.<sup>66</sup> The WST included higher rates for luxury or non-essential items (ranging upwards of 66% at times and applying to a varying list over the years including jewellery, furs, watches and beauty products).<sup>67</sup>

From the outset, the WST applied to the sale of motor vehicles and,<sup>68</sup> in keeping with the general deployment of the sales tax, the treatment of motor vehicles varied considerably over the decades motivated by differing 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 (but not always) 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 applying to deductions such as the claiming of luxury vehicles as a business expense.<sup>69</sup> 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.<sup>70</sup>

66 For an overview of the various historical iterations of the Wholesale Sales Tax ('WST'), see Julie Patricia Smith, 'The Changing Redistributive Role of Taxation in Australia since Federation' (PhD Thesis, Australian National University, 2002) ch 6 <<https://doi.org/10.25911/5d7a27076ed20>>. 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 that the tax was used primarily for revenue-raising: at 77–8. Smith further contends that sales tax policy was influenced by a deliberately redistributive rationale which manifested in lower or no taxation on necessities and higher rates on non-essential or luxury items: at 84–6.

67 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: Smith (n 66) 80.

68 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 *Sales Tax 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) ss 3, 17 (and associated Acts); Commonwealth, *Parliamentary Debates*, House of Representatives, 9 July 1930, 3902–3 (James Scullin); *Sales Tax Act (No 1) 1946* (Cth); *Sales Tax (Exemptions and Classifications) Act 1947* (Cth) s 3(o) item 135.

69 The sales tax was one of a number of protectionist levers for the domestic vehicle-manufacturing industry including most prominently tariffs which had been selectively applied to the import of motor vehicles since at least World War I. For an overview, see Smith (n 66) ch 6. See reforms to limit the depreciation allowance for cars to AUD18,000 in 1980 as a means of preventing excessive deductions for expensive vehicles: *Income Tax Assessment Act Amendment Act (No 2) 1980* (Cth).

70 See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 5 August 1930, 5305–9 (Ben Chifley); Commonwealth, *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 they were included in the second schedule, the rate of which rose from 5% to 20% across the decade. This

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 a new luxury rate of 30% imposed above it.<sup>71</sup> The stated rationale was to dampen consumer demand to address the trade deficit rather than one of redistribution. However, the then Treasurer Paul Keating acknowledged that the overall package of budget measures was designed to protect the ‘most needy’.<sup>72</sup> The conservative opposition accused the Government of an ‘envy spasm’, whereby the ‘envy principle overcomes economic common sense’.<sup>73</sup> It condemned the move as protectionist and argued that it was designed to increase the price of more expensive European car imports while preserving the tax position of domestically produced cars (which were mainly under the threshold at which the luxury rate applied).<sup>74</sup> However, the trend of unwinding protectionist measures for the domestic automotive industry, such as the removal of tariffs and quotas, is not entirely commensurate with these changes – beginning before the introduction of the luxury rate and accelerating after it. Protectionism is therefore likely to be part of the story for the higher rated sales tax for luxury cars but not the whole story.<sup>75</sup>

Prior to the introduction of the GST, the WST contained 5 schedules with 5 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).<sup>76</sup> From 1993, the method for calculating sales tax on luxury vehicles changed from one

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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) s 5; *Sales Tax Act (No 1) 1951* (Cth) s 3(4). A subsequent change introduced in 1956 and remaining until the repeal of the WST 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.

71 *Sales Tax (Exemptions and Classifications) Amendment Act 1986* (Cth) s 5 pt 2 inserting *Sales Tax (Exemptions and Classifications) Act 1986* (Cth) sch 2 item 39; 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 Committee Report on Luxury Car Tax 2008* (n 53) 5 [2.2].

72 Commonwealth, *Parliamentary Debates*, House of Representatives, 19 August 1986, 261–2 (Paul Keating). ‘The savings and tax decisions ... are also designed to restrain the growth of private consumption’: at 260.

73 Commonwealth, *Parliamentary Debates*, House of Representatives, 22 September 1986, 1139 (James Carlton).

74 ‘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* (Canberra, 20 August 1986) 28; *Senate Committee Report on Luxury Car Tax 2008* (n 53) 5 [2.2].

75 For an overview of the history of trade protectionist measures in support of the domestic automotive industry, see David Richardson, ‘Protection in the Motor Vehicle Industry’ (Current Issues Brief No 22, Parliament of Australia, 7 February 1997); Ann Capling and Brian Galligan, *Beyond the Protective State: The Political Economy of Australia’s Manufacturing Industry Policy* (Cambridge University Press, 1992); Michael Emmery, ‘Australian Manufacturing: A Brief History of Industry Policy and Trade Liberalisation’ (Research Paper No 7, Parliament of Australia, 19 October 1999).

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



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).<sup>77</sup>

The centrepiece of the A New Tax System Reform was the introduction of a broadly-based, single-rated 10% GST in 2000 to replace the multi-rated WST.<sup>78</sup> The GST was motivated by a desire to be as neutral as possible towards market-based decisions to produce or consume, which marked a shift from the graduated rates and schedules of 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. 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 the 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’.<sup>79</sup> As the package introducing the reforms explained:

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 ... The tax will ensure that luxury cars only fall in price by about the same amount as a car just below the luxury threshold.<sup>80</sup>

The reasons why cars were the only item singled out from the list of items taxed at the luxury rate 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 audiovisual 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.<sup>81</sup> Perhaps part of the explanation lies in the existence of the Australian domestic automotive manufacturing industry.

The LCT itself has undergone a number of changes since its introduction – mostly in 2008 when the Labor Government increased the rate from 25% to 33%.<sup>82</sup>

77 Explanatory Memorandum, Sales Tax (General) (Deficit Reduction) Bill 1993 (Cth) ch 3; *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 stripped equipment from cars to fall below the hard threshold at which the tax would literally double): Michael Lynch, ‘Car Industry Relieved at Soft-Pedal Taxation’, *Australian Financial Review* (Sydney, 18 August 1993) 3.

78 *GST Act* (n 5); *A New Tax System (End of Sales Tax) Act 1999* (Cth) s 3.

79 Matthew Horan, ‘Top-Up Levy to Limit Fall in Luxury Car Prices’, *The Advertiser* (Adelaide, 14 August 1998) 6.

80 Treasury, ‘Tax Reform: Not a New Tax, a New Tax System’ (Tax Reform Plan, Australian Government, August 1998) 89.

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

82 Commonwealth, ‘Budget Paper No 1: Budget Strategy and Outlook 2008–09’ (Budget Paper, 13 May 2008) 37; *A New Tax System (Luxury Car Tax Imposition – General) Act 1999* (Cth) s 4; *A New Tax*

In addition, various changes have been made for different sectors,<sup>83</sup> including the introduction of a rebate scheme in 2008 for eligible primary producers and tourism operators, and the introduction of a higher threshold for fuel-efficient vehicles.<sup>84</sup>

This brief history shows that, although the LCT was introduced to secure the introduction of the GST, the deeper history of the WST treatment of cars generally, and luxury cars in particular, reveals a number of other motivating rationales. These factors include, but are not limited to: protectionism, redistribution, economic intervention (eg, to address trade and budget deficits), and a desire to supplement the deficiencies of the income tax. In sum, what history demonstrates is that the LCT offers a perfect example of the second-best, whereby tax outcomes reflect historically embedded political and economic ideas and contests. While one might not necessarily introduce or design such a tax from scratch (compare Parts IV–VI), in the absence of wholesale reform, such taxes are often what policymakers are left to work with. To suggest that having secured the introduction of the GST, the LCT is now an anachronism without merit 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 do not matter because the progressive rate-scale of the pre-existing WST is no longer a relevant comparator. Similar to the criticisms levelled at law and economics, the underlying assumption of the campaign to repeal the LCT is that our commitment to important questions around the distribution of the tax burden is very shallow indeed (see Part VI of this article for why these commitments should instead be deep). Likewise, to claim that the demise of domestic automotive manufacturing obviates the need for the maintenance of the LCT misses the point that, irrespective of historical rationales, the LCT exists and should be assessed on its merits which are not merely historic (which Part IV undertakes).

### C An Outlier? The LCT in Comparative Context

It is worth examining the use of LCTs elsewhere given the implication in the arguments to repeal the LCT that it only exists for parochial and anachronistic reasons. Australia is not alone in applying additional taxation on the sale or importation of luxury vehicles, but different jurisdictions do so in different ways. With the rise of general consumption taxes, namely the Value-Added Tax ('VAT') or GST, across the latter part of the 20<sup>th</sup> century and the consequent decline in

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*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.

83 Limited changes were introduced following the Ralph Review of Business Taxation such as the exclusion from the luxury tax threshold of the value of modifications made to a non-luxury vehicle for the purposes of transporting disabled persons: see, eg, *LCT Act* (n 5) s 5-20(5); Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable* (Report, July 1999) 331–2.

84 *Tax Laws Amendment (Luxury Car Tax) Act 2008* (Cth) sch 1, inserting *LCT Act* (n 5) ss 25-1(4)–(6).

specific excises (as well as tariffs), luxury taxes are less common especially in developed countries with more robust revenue-raising capacities.<sup>85</sup>

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 VATs focus on the need to protect the poor.<sup>86</sup> 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.<sup>87</sup> Only one (India) applies this higher rate to motor vehicles.<sup>88</sup>

Nevertheless, motor vehicles are a very frequent subject for ‘progressive’ and ‘luxury’ rate taxation including under: specific indirect taxes such as excise taxes and select luxury taxes;<sup>89</sup> registration regimes or periodic taxes on ownership and/or use;<sup>90</sup> and through differential customs duty tariffs on imported high value vehicles.<sup>91</sup> 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’ which includes factors such as environmental considerations and other externalities not captured by price alone.<sup>92</sup>

85 See, eg, *OECD Consumption Tax Trends 2020* (n 14) 14–18 [1.3].

86 See James, *The Rise of the Value-Added Tax* (n 50) 108–9.

87 Fabiola Annacondia, ‘Overview of General Turnover Taxes and Tax Rates: January 2021’ (2021) 32(2) *International VAT Monitor* 122.

88 Ibid 126 n 58.

89 See, eg, Israel which imposes an additional luxury rate for vehicles above a certain threshold under its purchase tax: *OECD Consumption Tax Trends 2020* (n 14) 170–1, annex 4A (Taxes on vehicles). Russia has a transport tax with a ‘scale-up factor’ introduced from 1 January 2014 to tax luxury cars: PricewaterhouseCoopers, ‘Global Automotive Tax Guide’ (Guide, November 2019) 345.

90 *OECD Consumption Tax Trends 2020* (n 14) 171. See, eg, Greece which imposes a registration tax with a graduated tax rate scale by vehicle value and emissions: at annex 4A (Taxes on vehicles).

91 See, eg, the Philippines imposes an excise rate of 50% on vehicles over PHP4 million: see, eg, ‘DTI Imposes Additional Taxes on Imported Cars’, *CNN Philippines* (online, 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>>. Thailand had, at the time of publication, an 80% rate on luxury vehicles in addition to other general taxes: Wichit Chantanusornsiri, ‘Customs Floats Luxury Car Tax Cut’, *Bangkok Post* (online, 30 January 2018) <<https://www.bangkokpost.com/thailand/general/1404142/customs-floats-luxury-car-tax-cut>>. There was an increase in the then luxury car tax rate in Vietnam from 60% to 130% to 150% for certain vehicles based on engine size which apparently led to Rolls-Royce ending distribution in Vietnam: ‘Vietnam’s Super Luxury Car Market Shrinks because of Sky-High Taxes, Fees’, *VietNamNet* (online, 30 October 2020) <<https://vietnamnet.vn/en/vietnams-super-luxury-car-market-shrinks-because-of-sky-high-taxes-fees-682934.html>>.

92 *OECD Consumption Tax Trends 2020* (n 14) 169–70.

Examples of specific forms of luxury taxes on motor vehicles include the recent proposal to introduce a luxury goods tax on cars, aircraft and boats in Canada<sup>93</sup> and the introduction of a 10% tax on ‘ultra-luxury cars’ from December 2016 in China ‘to combat conspicuous consumption and promote more fuel-efficient vehicles’.<sup>94</sup> By contrast, the region which hosts the most manufacturers of luxury vehicles, the European Union, has conducted a coordinated campaign against luxury car taxes and/or rates in the course of negotiating a series of free trade agreements.<sup>95</sup>

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.<sup>96</sup>

### D The Efficiency and Fairness Objections

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

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.<sup>97</sup>

The *Henry 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.<sup>98</sup> Second, the tax is inefficient

93 The proposed tax due to take effect on 1 September 2022 would apply to the sale of new luxury cars and aircraft with a retail sale price over CAD100,000 and new boats over CAD250,000. It would be calculated either on 10% of the total value of the vehicle, vessel or aircraft or 20% of the value in excess of the relevant threshold. For the draft legislation, see Chrystia Freeland, ‘Legislative Proposals Relating to the *Select Luxury Items Tax Act*’ (Draft Legislation, Canada, 2022) <<https://fin.canada.ca/drleg-apl/2022/ita-lir-0322-l-bil.pdf>>.

94 Frank Jacobs, ‘10% Tax on Ultra-Luxury Cars in China’, *Global Fleet* (Web Page, 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>>.

95 Vietnam has agreed to phase out taxes on the importation of luxury vehicles from the European Union (‘EU’) from 70% to 0% over the next 10 years as part of a free trade agreement (‘FTA’) signed with the EU: see, eg, ‘VN Taxes on EU’s Cars to Fall to 0%’, *The Phnom Penh Post* (online, 8 July 2019) <<https://www.phnompenhpost.com/business/vn-taxes-eus-cars-fall-0>>. EU negotiators are applying similar pressure on Australia to repeal the LCT in the context of ongoing FTA negotiations: Gray (n 54). See also the failed attempt by the EU to challenge a (now abandoned) luxury tax on automobiles levied in the United States, where the Panel Report was circulated on 11 October 1994, but not adopted: ‘EU versus US: Car Taxes’, *World Trade Organization* (Web Page) <[https://www.wto.org/english/tratop\\_e/envir\\_e/edis06\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/edis06_e.htm)>.

96 See generally PricewaterhouseCoopers, ‘Global Automotive Tax Guide’ (Guide, November 2018); *OECD Consumption Tax Trends 2020* (n 14) 169–70 [4.2].

97 *Henry Review Detailed Analysis* (n 6) vol 2, 469, 476.

98 *Ibid* 476.

in effect because it distorts market outcomes.<sup>99</sup> Relatedly, the *Henry Review* (and other commentators) express concern over 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). As Part III explained, the environmental objections to the LCT are not considered in detail by this article.<sup>100</sup> Third, the tax is unfair and discriminatory in its impact (targeting people of equal means based purely on their tastes) and fails to sufficiently redistribute resources from rich to poor (because of its narrow base and failure to target the expenditure of just the rich).<sup>101</sup>

The critique of the *Henry Review* is significant. First, the *Henry Review* constitutes the last major review of the Australian tax system and one which exhibits an enthusiastic embrace of the centrality of efficiency as an organising principle and which reveals the influence of optimal tax theory.<sup>102</sup> Its objection to the LCT on efficiency and fairness grounds therefore offers an ideal vehicle to explore the limits of the law and economics approach. These are explored in three parts: Part IV offers an assessment of the real-world performance of the LCT including its administrative efficiency according to revenue-generation relative to administration and compliance costs; Part V considers the economic efficiency objections relative to market behaviour and distortions; and Part VI considers the fairness critique.

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99 Ibid 469.

100 However, for more on the environmental considerations that affect the assessment of LCT, the *Henry Review Detailed Analysis* 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 advocates instead for an emissions trading scheme to address the issue: see *Henry Review Detailed Analysis* (n 6) vol 2, 476. 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 and James Ha, *Towards Net Zero: Practical Policies to Reduce Transport Emissions* (Grattan Institute Report No 2021-07, 18 July 2021) 4, 19; Greg Brown, ‘Coalition Split over Tax on Electric Cars’, *The Australian* (online, 14 April 2021) <<https://www.theaustralian.com.au/nation/politics/coalition-split-over-tax-on-electric-cars/news-story/f88ea3c6c5e1f4a57f435a9ddf4a90a6>>. The *ANAO Report 2011* notes that motoring bodies regard the LCT as a deterrent for new energy efficient cars: see *ANAO Report 2011* (n 3) 32 [1.29]. Andrew Tillet, ‘Time to Scrap \$1b in “Ridiculous” Car Taxes’, *Australian Financial Review* (online, 18 February 2020) <<https://www.afr.com/politics/federal/time-to-scrap-1b-in-ridiculous-car-taxes-20200218-p541ua>>. ‘Because safety and environmentally friendly technologies appear first as optional equipment, they usually appear on luxury vehicles first, but gradually diffuse to standard models’: *Senate Committee Report on Luxury Car Tax 2008* (n 53) 13 [2.45]. 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%) to affect research and development budgets: at 13 [2.47], 14 [2.49].

101 *Henry Review Detailed Analysis* (n 6) vol 2, 475.

102 See the recommendations of the *Henry Review* as an example: *Henry Review Overview* (n 13).

## IV EVALUATING THE OPERATION AND PERFORMANCE OF THE LUXURY CAR TAX

As Part III outlined, the *Henry Review* concluded that '[l]uxury taxes should not be used to raise revenue. They are inefficient because of their narrow base.'<sup>103</sup> The *Henry Review* referred to the fact that in 2007–08 the LCT raised AUD464 million in revenue or 0.1% of total taxation revenue before recommending its abolition.<sup>104</sup>

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 similarly low overall levels of revenue (of AUD348 million from 1 July 2018 to 30 June 2019 or well under 0.5% of GST revenue of AUD65.2 billion) at a relatively low administrative cost.<sup>105</sup>

This Part 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 tax is generally well-designed and administered as part of the overall GST system and generates revenue from an increasing tax base for appropriately low administrative and compliance costs. Although there is scope for improvement, as a majority of members in a 2008 Senate Committee review concluded, 'the LCT is a progressive tax which is relatively easy to collect'.<sup>106</sup>

### A Revenue Generation and the Tax Base

The LCT has generated almost AUD9 billion since its introduction at an average of AUD446 million 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.

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103 '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': *Henry Review Detailed Analysis* (n 6) vol 2, 469.

104 *Ibid* vol 2, 476.

105 Australian Taxation Office, *GST Administration Annual Performance Report 2018–19* (Report, 2019) 3, 14 tbl 2, 43 tbl 1.2; Australian Taxation Office, 'GST on Low Value Goods Measure Continues to Exceed Expectations' (Media Release, Australian Government, 4 July 2019).

106 *Senate Committee Report on Luxury Car Tax 2008* (n 53) 12 [2.40].



Table 1: LCT, GST and Total Tax Revenue ('TTR') from 2000–2020<sup>107</sup>

| 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%            |
| 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%            |

<sup>107</sup> Author calculations based on: Australian Taxation Office, 'Taxation Statistics 2018–19 GST and Other Taxes: Selected GST, WET and LCT Items, 2000–01 to 2019–20 Financial Years', *Taxation Statistics 2018–19* (Web Page, 28 November 2021) <[https://data.gov.au/data/dataset/taxation-statistics-2018-19/resource/c35adafd-11a3-448b-a495-633caa45d8b9?inner\\_span=True](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, 2019–20 Financial Year' (Catalogue No 5506.0, 27 April 2021) and previous year releases. Some notable peaks and troughs can be partly explained by legislated changes such as the increase of the rate from 25% to 33% in 2008 which resulted in increased revenues immediately prior to the change and decreased revenues immediately afterwards, reflecting the forward shifting of luxury car purchases in response to the announced changes.

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% of total vehicle sales since the introduction of the LCT to around 12% of total vehicle sales today.<sup>108</sup> The long-term trend of an increasing base is evident even when factoring in fluctuations in overall car sales<sup>109</sup> and has continued despite overall car sales declining through the global financial crisis and COVID-19 – with luxury car sales reaching record highs during the pandemic.<sup>110</sup> This led the previous government to revise LCT collections up by 42% from previous downward revisions.<sup>111</sup> There may be various reasons for the increase in luxury car sales, for example, the Australian Taxation Office (‘ATO’) notes that luxury car sales are affected by macroeconomic factors especially fluctuations in the exchange rate (given that most are imported).<sup>112</sup> Further interrogation of the reasons for these trends might provide some insight into the robustness of the base going forward. However, irrespective of the underlying causes, the data clearly shows a trend of increasing sales of luxury cars even during times of economic downturn.

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108 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 marque luxury car brands listed in Figure 1: CommSec, ‘Watchful Reserve Bank. Record Luxury Vehicles’ (Economic Insights, 20 April 2021) 2. The Australian National Audit Office (‘ANAO’) estimated that luxury car purchases constituted 10% or 100,000 of the total new car purchases for the 2010–11 financial year: *ANAO Report 2011* (n 3) 25 [1.2].

109 For data on overall car sales, see, eg, Australian Bureau of Statistics, *Sales of New Motor Vehicles: December 2017* (Catalogue No 9314.0, 16 January 2018). Post-2017 data is collected by the Federal Chamber of Automotive Industries as part of its VFACTS service. Recent data shows sales of 916,968 in 2020, down from 1,062,867 in 2019: ‘Australia’s New Vehicle Market’, *Federal Chamber of Automotive Industries* (Web Page) <<https://www.fc.ai.com.au/sales>>.

110 Wright, ‘No Recession for Those in the Market for a Luxury Car’ (n 4).

111 Shane Wright, ‘Economy Faring Better than Expected but Budget Bottom Line Deep into the Red’, *The Sydney Morning Herald* (online, 11 May 2021) <<https://www.smh.com.au/politics/federal/economy-faring-better-than-expected-but-budget-bottom-line-deep-into-the-red-20210507-p57px9.html>>. This follows downwards revisions to LCT revenues in the 2019–20 budget which suggests that uptick in LCT revenues which follows from a strong increase in luxury car sales was not foreseen by the Treasury: Josh Frydenberg and Mathias Cormann, ‘Budget 2019–20: Budget Strategy and Outlook’ (Budget Paper No 1, Commonwealth, 2 April 2019) 4–13.

112 Australian Taxation Office, ‘Trends and Latest Findings’, *Luxury Car Tax Gap* (Web Page, 19 October 2021) <[https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Luxury-car-tax-gap/?page=2#Trends\\_and\\_latest\\_findings](https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Luxury-car-tax-gap/?page=2#Trends_and_latest_findings)>. The Australian Taxation Office (‘ATO’) also notes a correlation with house values. Low interest rate settings might also affect the trend of increasing sales of luxury cars including during economic downturns. It might also reflect an increase in discretionary spending for those least financially affected by, or whose financial position improved during the pandemic and are seeking an outlet on spending other than travel. The trend for increased sales during COVID-19 has also been noted across other luxury items such as watches. ‘Demand for high-end watches exploded during the Covid-19 pandemic’: Robert Frank, ‘Luxury Watch Shortage Drives Growth of \$20 Billion Secondhand Market as Start-Ups Rush to Cash In’, *CNBC* (online, 13 October 2021) <<https://www.cnbc.com/2021/10/13/luxury-watch-shortage-drives-growth-of-20-billion-secondhand-market.html>>.

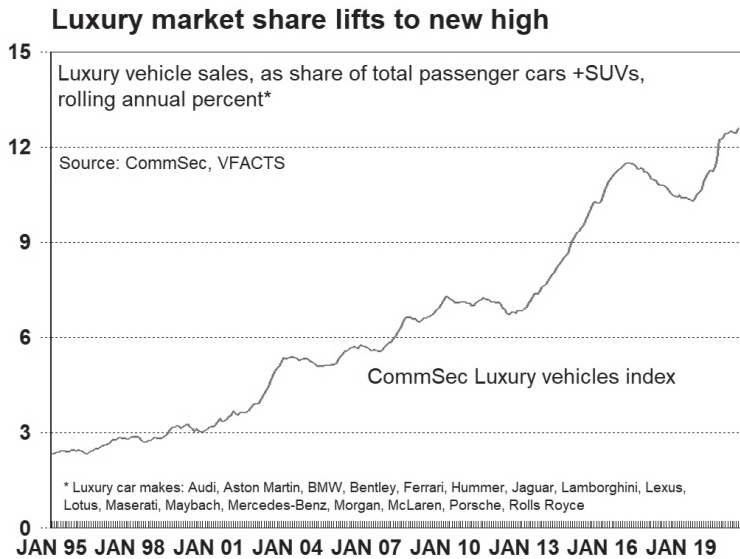


Figure 1: Luxury vehicle sales as a share of total passenger vehicles sold (1995–2019)<sup>113</sup>

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 estimates the top 10 vehicle makes and models for which the base price exceeds the luxury car tax threshold for 2020.

<sup>113</sup> CommSec (n 108) 1.

Table 2: Most Popular Vehicles Exceeding the Luxury Car Tax Threshold in 2020<sup>114</sup>

| 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                 |

This table highlights a constant criticism of the LCT – which is that the threshold for what determines a luxury vehicle is too low (currently either AUD69,152 or AUD79,659 for fuel efficient vehicles) and so is over-inclusive of vehicles which should not properly be considered luxury vehicles.<sup>115</sup> Perhaps this criticism might be valid given the inclusions on this list; however, this is an objection to the operationalisation of the tax (ie, the setting of its threshold at an appropriate level) rather than to the notion of an LCT per se.

## B 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.<sup>116</sup> Given that

<sup>114</sup> List compiled from the top 100 cars sold for 2020 and the price of the base model for the vehicles listed. The list is therefore likely to be under-inclusive – for example, the Toyota Prado base model falls under the luxury car tax threshold ('LCTT') but frequently features in lists of top selling vehicles that attract the LCT. Top-selling models that fall within the AUD60,000–70,000 range include: Toyota Prado (recommended retail price AUD60,830 ranked 8<sup>th</sup> of top-selling vehicles for 2020 and would be first on this list); Mercedes-Benz C-Class Series (AUD66,900 ranked 69<sup>th</sup> of top-selling vehicles and would rank 6<sup>th</sup> on this list); Volvo XC6 (AUD67,990 ranked 80<sup>th</sup> overall and would rank 8<sup>th</sup> on this list): see Justin Hilliard, 'Top 100 New Cars Sold in Australia in 2020', *CarsGuide* (Web Page, 9 January 2021) <<https://www.carsguide.com.au/car-news/top-100-new-cars-sold-in-australia-in-2020-82038>>. For an earlier, more reliable estimate showing a similar range of vehicles, see *ANAO Report 2011* (n 3) 26 [1.7] tbl 1.1.

<sup>115</sup> Dowling, 'Toyota Drivers Seeing Red over Tax' (n 56) 4.

<sup>116</sup> Customs/Border Force collected AUD54 million of a total of AUD8.927 billion collected for the period from 2000–20 (54/8927 = 0.6049%). Calculations from data contained in Table 1 above: *ANAO Report 2011* (n 3) 34 [2.4].

the LCT raises on average 0.145% of total tax revenue, it accordingly receives a low administrative priority.<sup>117</sup> 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 attributable to the LCT.<sup>118</sup> However, the Australian National Audit Office ('ANAO') noted in a 2011 review of the administration of the LCT that:

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.<sup>119</sup>

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 has generated very few requests for interpretive assistance, including for private binding rulings, which led the ANAO to infer 'that taxpayers have a good understanding of the tax and its application'.<sup>120</sup> The ANAO review further noted that '[c]ar dealers interviewed were generally unconcerned with the cost of complying with the tax'.<sup>121</sup> However, the ANAO review cautioned 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.<sup>122</sup>

Relatively low administrative and compliance costs most likely result from LCT revenue being highly concentrated – with a small number (100 or 6%) of large taxpayers (including car retailers, importers, wholesalers and manufacturers) who are well-placed to comply contributing the bulk of revenue (84% in 2009–10).<sup>123</sup> Low costs are also likely a product of the economic incidence of the LCT

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117 Ibid 37 [2.13].

118 The only regular reporting on the LCT is the reporting of annual revenue figures. The ANAO notes that the failure to disaggregate administrative costs for the LCT suggests such costs are low: *ibid* 35–41, 37 [2.12]; Australian Taxation Office, *Annual Report 2019–20* (Report, October 2020) ch 4.

119 *ANAO Report 2011* (n 3) 13 [10]. See also 49–50 [3.19]–[3.25] for information on how the ATO benchmarks risk including comparing LCT revenue collected against data on luxury vehicle sales.

120 *Ibid* 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': at 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, Australian Taxation Office, 'Luxury Car Tax: Meaning of "Luxury Car"' (Class Ruling 2012/81, 1 January 2007); Australian Taxation Office, 'Luxury Car Tax: Meaning of "Luxury Car"' (Class Ruling 2012/37, 1 February 2005); Australian Taxation Office, 'Class Rulings System' (Class Ruling 2001/1, 28 February 2001). Beyond LCT Determinations 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)): Australian Taxation Office, 'Luxury Car Tax: Does the Luxury Car Tax Value for a Car Acquired under a Purchase Agreement include the Consideration Provided for the Supply of Credit under the Agreement' (Luxury Car Tax Determination 2014/1, 12 March 2014). Search conducted 17 September 2021.

121 *ANAO Report 2011* (n 3) 42 [2.36].

122 *Ibid* 36–7 [2.10]–[2.15]. '[S]hortcomings in individual components of overall compliance arrangements limit the assurance that taxpayers are meeting their LCT obligations': at 55–6 [3.48].

123 *Ibid* 45 [3.2]. Up until 2011, annual LCT revenue was typically paid by less than 1,000 taxpayers (approximately 59% of the 1,692 taxpayers with an LCT account). On 31 December 2010, there were 379 motor vehicle entities in the large market segment, of which 138 entities were LCT taxpayers: at

(explored in Part VI) and the legislative design and implementation of the LCT which is integrated into that of the GST explored below and at Part IV(B).

The LCT forms part of the general reporting and administrative provisions of the GST (or for customs duty for LCT on taxable importations).<sup>124</sup> This synthesised reporting and administration was designed to minimise compliance costs, '[w]hen 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.'<sup>125</sup>

Most LCT taxpayers will have an Australian Business Number and be registered for GST purposes (with no separate registration for the LCT).<sup>126</sup> Both taxes are reported via business activity statements ('BAS') (with LCT accounted for under an LCT label in a BAS return) and reporting periods and attribution rules align with the GST.<sup>127</sup> As with the GST, provision is made for adjustments.<sup>128</sup>

### C Legislative Design

The LCT is drafted and implemented to complement the GST. Thus, the LCT is payable (at a rate of 33%)<sup>129</sup> on a taxable supply<sup>130</sup> or taxable importation<sup>131</sup> of a luxury car<sup>132</sup> when the luxury car tax value ('LCTV')<sup>133</sup> of that vehicle exceeds the luxury car tax threshold ('LCTT') (set at AUD69,152 or AUD79,659 for fuel-efficient cars in financial year 2021/22).<sup>134</sup>

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18 [29], 27 [1.9] fig 1.1, 30 [1.21], 52 [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(1) *Tax Law Review* 1, 34 ('How Should Governments Promote Distributive Justice').

124 *LCT Act* (n 5) pt 3, ss 13-20, 13-25; *GST Act* (n 5) div 17.

125 *ANAO Report 2011* (n 3) 30 [1.19].

126 *Ibid* 30 [1.20].

127 *LCT Act* (n 5) ss 13-5, 13-15(1)–(1A). LCT is added to net amounts under division 17 of the *GST Act* (n 5). Separate credit and recovery provisions apply for taxpayers who are not registered under the Goods and Services Tax ('GST'): *LCT Act* (n 5) div 17; *ANAO Report 2011* (n 3) 53 [3.37].

128 An increasing adjustment is required when more LCT is payable, such as when LCT was not paid because the vehicle was intended to be used as trading stock but then later used privately. A decreasing adjustment occurs when less LCT is payable, including for bad debts: *LCT Act* (n 5) s 13-10, div 15.

129 *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.

130 *LCT Act* (n 5) s 5-10.

131 *Ibid* s 7-10.

132 *Ibid* divs 5, 7, ss 25-1, 27-1. 'Car' means a motor vehicle (including four-wheel drives but excluding motorcycles) that is designed to carry a load of less than two tonnes and fewer than nine 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.

133 The luxury car tax value is determined differently for taxable supplies (section 5-20) and taxable importations (section 7-15): *LCT Act* (n 5) ss 5-20, 7-15.

134 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: *LCT Act* (n 5) s 25-1; *Income Tax Assessment Act 1997* (Cth) s



The LCT is only payable on the value of the car that exceeds the LCTT. Although the calculation of 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 LCTT.<sup>135</sup> The LCT applies to eligible purchases by both final consumers and businesses, but there are specific rebates available for primary producers and tourism operators.<sup>136</sup>

The amount of LCT payable is calculated according to the following formula:

$$\text{Rate} \times (10 \div 11) \times [\text{LCTV} - \text{LCTT}].^{137}$$

Figure 2 provides a worked example.

Leviathan Showrooms sells a Rolls-Royce Ghost for AUD628,000 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:<sup>138</sup>

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

$$33\% \times (10 \div 11) \times 558,848 = \text{AUD}167,654.40$$

Leviathan Showrooms charges their customer, Alexis Downer, AUD795,654.40 (AUD628,000 including GST (of AUD57,090) plus AUD167,654.40 LCT) for the vehicle excluding stamp duty, insurance, registration and other charges. Total Commonwealth tax paid is AUD224,745.31 (approximately 28% of the purchase price).

Figure 2: Calculation of LCT on a luxury vehicle (not fuel-efficient)

The legislation adopts similar legislative criteria to the GST for triggering tax liability, for example, in adopting the terms ‘taxable supply’ and ‘taxable importation’ which are defined in line with the GST legislation.<sup>139</sup> As with the GST, a taxable supply of a luxury car has positive and negative elements,<sup>140</sup> but the LCT specifically excludes instances when a recipient quotes for the supply of a

40-230 (and the former sub-div 42-B); ‘Luxury Car Tax Rate and Thresholds’, *Australian Taxation Office* (Web Page, 28 May 2021) <<https://www.ato.gov.au/rates/luxury-car-tax-rate-and-thresholds/>>.

135 *ANAO Report 2011* (n 3) 29 [1.16].

136 *LCT Act* (n 5) div 18.

137 The LCT is 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 divided by 11: Explanatory Memorandum, A New Tax System (Luxury Car Tax) Bill 1999 (Cth) 7 [1.13]. *LCT Act* (n 5) s 5-15 (for taxable supplies), s 7-15(1) (for taxable importations).

138 See also ‘Working Out the LCT on a Sale’, *Australian Taxation Office* (Web Page, 28 May 2021) <<https://www.ato.gov.au/business/luxury-car-tax/working-out-the-lct-amount/working-out-the-lct-on-a-sale/>>.

139 *LCT Act* (n 5) div 5, taxable supplies of luxury cars mirrors division 9 of the *GST Act* (n 5) so that a *taxable supply of a luxury car* is defined in the *LCT Act*, and by reference to the GST legislation. For example, the ‘taxable supply of a luxury car’ is defined in section 5-10, but the constitutive terms of ‘supply’ and ‘taxable supply’ take their meaning from the *GST Act* – ‘supply has the meaning given by section 9-10 of the *GST Act*’, ‘taxable supply has the meaning given by section 195-1 of the *GST Act*’: *LCT Act* (n 5) ss 5-10, 27-1; *GST Act* (n 5) ss 9-10, 195-1. Division 7 of the *LCT Act* (taxable importation of luxury cars) mirrors division 13 of the *GST Act*.

140 *LCT Act* (n 5) s 5-10. Cf *GST Act* (n 5) s 9-10.

car (see below) or when the car is more than two years old.<sup>141</sup> Similar to the GST, a taxable importation of a luxury car triggers LCT liability if the luxury car (including parts and accessories)<sup>142</sup> is imported and entered for home consumption,<sup>143</sup> 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 the LCT has already become payable.<sup>144</sup>

A system of quoting<sup>145</sup> enables suppliers<sup>146</sup> or importers<sup>147</sup> of vehicles who are registered under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) 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.<sup>148</sup> This deferral of payment is designed to avoid the tax being payable until it reaches a final or business consumer,<sup>149</sup> but presents an obvious 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.<sup>150</sup> Both the GST and the LCT are subject to specific anti-avoidance rules (eg, associate provisions)<sup>151</sup> and the general anti-avoidance rules in the GST legislation apply to the LCT.<sup>152</sup>

## D Case Law and Compliance

Further evidence of the low administrative and compliance burden of the LCT is the relatively small number of disputes which have come before the Administrative Appeals Tribunal ('AAT') and the courts. Since its introduction,

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

142 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 that such practices have not occurred (or at least not enough to generate case law) which suggests that the costs of avoiding the LCT in this manner might outweigh the benefits: *LCT Act* (n 5) s 7-10(2); *GST Act* (n 5) s 195-1 (definition of 'car parts').

143 *GST Act* (n 5) div 13, s 13-5(1). Cf *LCT Act* (n 5) div 7, s 7-10(1); *Customs Act 1901* (Cth) s 68.

144 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: *LCT Act* (n 5) ss 7-10(3), 7-20, 27-1.

145 *Ibid* pt 2 div 9.

146 *Ibid* s 5-10(2).

147 *Ibid* s 7-10(3).

148 *Ibid* s 9-5.

149 Explanatory Memorandum, *A New Tax System (Luxury Car Tax) Bill 1999* (Cth) 9 [2.3].

150 *LCT Act* (n 5) ss 9-10(4) (obligation to notify the supplier if not eligible to quote on a supply – 20 penalty units), 9-30 (penalties for improper quoting – 20 penalty units).

151 *Ibid* ss 5-20(2)–(4).

152 The division 165 anti-avoidance rules in the GST legislation apply to both GST and LCT: *GST Act* (n 5) div 165; *LCT Act* (n 5) ss 13-1, 13-30 ('Division 165 of the GST Act applies to amounts payable under this Subdivision as if they were amounts payable under the GST Act'). Explanatory Memorandum, *A New Tax System (Luxury Car Tax) Bill 1999* (Cth) 11 [2.18].

the LCT has been the primary subject of a total of 8 litigated disputes (and featured peripherally in a further 20 or so disputes) with 1 resolved by the Full Federal Court,<sup>153</sup> 2 by a single judge of the Federal Court,<sup>154</sup> and the remainder by the AAT. All but two cases concerned overlapping issues with the GST and LCT (the most common being entitlement to input tax credits under the GST) and all but one case concerned attempts to misuse the quoting mechanism to avoid paying the LCT.<sup>155</sup>

The case law highlights that the main compliance risk for the LCT is the 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 the LCT by (incorrectly) 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)<sup>156</sup> 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.<sup>157</sup> In reality, the vehicles are variously used for ‘extended’ test drives, personal use or informally leased or sold.<sup>158</sup> 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

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153 *Dreamtech International Pty Ltd v Federal Commissioner of Taxation* (2010) 187 FCR 352 (concerning the meaning of the undefined term ‘limousine’ in the definition of luxury car) (*‘Dreamtech’*).

154 *Melbourne Car Shop Pty Ltd v Commissioner of Taxation* (2010) 76 ATR 42 (*‘Melbourne Car Shop’*); *Stallion (NSW) Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1306 (*‘Stallion’*).

155 The remaining case was *Dreamtech* (n 153).

156 *Melbourne Car Shop* (n 154) (car dealer of low to mid-range cars failed to establish that the luxury cars were 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 failed to support his claim to run a luxury car dealership to the Tribunal’s satisfaction (no anti-avoidance argument pursued by the Commissioner)); *Mavris and Commissioner of Taxation (Taxation)* [2018] AATA 1825 (taxpayer who 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 on others); *Skourmallas and Commissioner of Taxation (Taxation)* [2019] AATA 5535 (taxpayer satisfied the 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)).

157 *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* (n 154) [195]–[248] (Thawley J) (taxpayer failed to show that the assessment by the Commissioner was excessive, they 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 were run by the Commissioner.

158 ‘Get Your LCT Right’, *Australian Taxation Office* (Web Page, 2 November 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’, *Australian Financial Review* (Sydney, 14 June 2011) 1.

requirements of the GST).<sup>159</sup> This means that a ‘business entity with no prior or current dealings in motor vehicle sales can register for LCT’.<sup>160</sup> Risks can consist of entities registering for the LCT but not reporting any transactions and entities that should register for the LCT 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’.<sup>161</sup>

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 2014–15 to 7.8% in 2017–18.<sup>162</sup> However, this tax gap is comparable to an overall average tax gap across all taxes of 6.9%,<sup>163</sup> including the GST which had a tax gap of 7.3% for 2017–18.<sup>164</sup> The ATO notes that the LCT tax gap is subject to fluctuations in the sale of luxury cars.<sup>165</sup> If 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 second-best tax instrument that applies on a narrow base of a single item of consumption expenditure, being luxury cars), the tax performs well. It is levied on an increasing, rather than shrinking, tax base and generates revenue relatively efficiently at low administrative and compliance costs because it is well designed and implemented as part of the overall GST system. 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, these are design issues which go to the operationalisation of the tax. The next two Parts consider the more fundamental theoretical critiques levelled at the LCT that it is inefficient and unfair.

## V ASSESSING THE EFFICIENCY CASE FOR AND AGAINST THE LCT

A 2008 discussion paper for the *Henry Review* objected to the LCT on the basis that, in targeting a single item of expenditure, the tax is distortive and arbitrary:

<sup>159</sup> *ANAO Report 2011* (n 3) 18 [31], 51 [3.28]–[3.29].

<sup>160</sup> *Ibid* 18 [31].

<sup>161</sup> Australian Taxation Office, ‘Get Your LCT Right’ (n 158).

<sup>162</sup> The LCT tax gap was 10.1% (AUD69 million) for 2015–16, 5.8% (AUD42 million) for 2016–17, and 7.8% (AUD58 million) in 2017–18: Australian Taxation Office, *Annual Report 2019–20* (n 118) 63 tbl 3.5.

<sup>163</sup> The tax gap across all taxes of was 7.7% (2015–16), 7.2% (2016–17) and 6.9% (2017–18): *ibid* 63 tbl 3.4.

<sup>164</sup> The tax gap for the GST was 7.5% (AUD4,453 million) in 2014–15, 8.2% (AUD5,146 million) in 2015–16, 6.9% (AUD4,527 million) in 2016–17, 7.3% (AUD4,978 million) in 2017–18 and 8.1% (AUD5,776 million) in 2018–19: *ibid* 63 tbl 3.5.

<sup>165</sup> 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 that the majority of vehicles subject to LCT are imported: ‘Luxury Car Tax Gap: Trends and Latest Findings’, *Australian Taxation Office* (Web Page, 19 October 2021) <[https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Luxury-car-tax-gap/?page=2#Trends\\_and\\_latest\\_findings](https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Luxury-car-tax-gap/?page=2#Trends_and_latest_findings)>.

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.<sup>166</sup>

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 (the substitution effect) which, in turn, might mean that manufacturers and importers might favour the production and importation of these items over luxury vehicles.<sup>167</sup> This objection reflects the law and economics concern of efficiency as equating to non-distortion – 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).<sup>168</sup>

The argument is superficially appealing but oversimplifies a contested literature which includes the general objections outlined in Part II(A) that highlight the many ways in which markets fail to maximise welfare and more foundational objections to the very notions of a pre-tax market position and post-tax interference.<sup>169</sup> 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.<sup>170</sup> However, as this Part 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, but 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 redistribution, this is the personal income tax and spending. As the *Henry Review* states:

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

166 Australia's Future Tax System Review Panel, *Architecture of Australia's Tax and Transfer System* (Report, 6 August 2008) 281; *Henry Review Detailed Analysis* (n 6) vol 2, 469.

167 See, eg, Louis Kaplow, *The Theory of Taxation and Public Economics* (Princeton University Press, 2008) 122; McPherson et al (n 59) 19–20.

168 See, eg, Ian Crawford, Michael Keen and Stephen Smith, 'Value Added Tax and Excises' in Stuart Adam et al (eds), *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, 2010) 275, 283; McPherson et al (n 59) 19.

169 Murphy and Nagel (n 10) 74.

170 The use of excise taxes for redistribution is not generally conceived of as addressing negative externalities. However, for arguments as to why expenditure on certain commodities including luxury items might create negative externalities, see Part VI.

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.<sup>171</sup>

This article 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).<sup>172</sup>

However, whereas the *Henry Review* is optimistic on the actual capacity of the income tax and transfer system to redistribute effectively, this article takes a much dimmer view. The *Henry Review*'s optimism is informed by its pro-consumption tax position (informed by optimal tax theory) in favour of the progressive taxation of labour income but with a deliberately concessionary approach to the taxation of capital income based on the familiar (but contested) claims outlined in Part II(A) that to tax capital income is distortionary.<sup>173</sup> By contrast, this article's pessimism is informed by a commitment to the idea that effective redistribution is best served if all (or at least more) income is taxed on a progressive basis.<sup>174</sup>

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 (as is evidenced by the move away from the taxation of capital income and the compression of progressive rates)<sup>175</sup> and permissive neglect (through a regulatory structure that facilitates tax gaming whereby high wealth and income individuals can defer or shelter income through the use of trusts and corporate entities).<sup>176</sup>

Two consequences follow from this. 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

171 *Henry Review Detailed Analysis* (n 6) vol 2, 475.

172 See, eg, AB Atkinson and JE Stiglitz, 'The Design of Tax Structure: Direct versus Indirect Taxation' (1976) 6(1–2) *Journal of Public Economics* 55, 68, 70, 74 <[https://doi.org/10.1016/0047-2727\(76\)90041-4](https://doi.org/10.1016/0047-2727(76)90041-4)>; Kaplow, *The Theory of Taxation and Public Economics* (n 167) 122.

173 *Henry Review Overview* (n 13) 32. In this respect, the *Henry Review* is broadly consistent with the main precepts of optimal tax theory: Mirrlees (n 35) 175–6; Kaplow, *The Theory of Taxation and Public Economics* (n 167) 122–3. For criticisms of the claims, see, eg, Daniel Shaviro, 'Beyond the Pro-Consumption Tax Consensus' (2007) 60(3) *Stanford Law Review* 745, 746–7; Joseph E Stiglitz, 'In Praise of Frank Ramsey's Contribution to the Theory of Taxation' (2015) 125(583) *Economic Journal* 235, 245–6 <<https://doi.org/10.1111/eoj.12187>>; Gamage, 'How Should Governments Promote Distributive Justice' (n 123) 7. For the classic summary of the divide between income and consumption taxation, see, eg, William D Andrews, 'A Consumption-Type or Cash Flow Personal Income Tax' (1974) 87(6) *Harvard Law Review* 1113 <<https://doi.org/10.2307/1340076>>; Warren (n 42) 1081.

174 See, eg, Diamond and Saez (n 38) 167–83. Cf Atkinson and Stiglitz (n 172) 57.

175 See, eg, Treasury, 'Tax Benchmarks and Variations Statement 2019' (Statement, Australian Government, January 2020) 17 tbl 3.1. The Morrison Government brought forward (with bipartisan support) 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* (Cth); *Treasury Laws Amendment (Tax Relief so Working Australians Keep More of Their Money) Act 2019* (Cth); *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* (Cth) sch 1.

176 Vann provides an account of both these trends: Richard Vann, 'In Defence of the Income Tax' (2019) 34(4) *Australian Tax Forum* 831, 835, 837–50.



neutrality is used to argue against the taxation of capital income and wealth (and in other instances to arbitrarily cap spending),<sup>177</sup> thus reducing the very capacity of the income tax (and transfer system) to redistribute.<sup>178</sup> 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 note in their review of VAT and excise taxes for the Mirrlees Review in the United Kingdom, '[o]ne 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'.<sup>179</sup>

In this context, there is a qualified case for the retention of the LCT (as a second-best option). In relation to the LCT, we might express this as a question in the following terms: in light of the reduced progressivity of the income tax and the fact that highly targeted transfers are only designed to compensate the poor, are there arguments grounded both in efficiency and fairness for the general use of select excise taxes and the specific application of such taxes to luxury vehicles?<sup>180</sup> The remainder of this Part examines the efficiency arguments, and Part VI addresses the fairness concerns.

One argument for the general use of select excises rests on empirical evidence which shows that the response of high income earners 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.<sup>181</sup> Gamage contends that once tax gaming is taken into account, it makes sense to use 'supplementary policy instruments' such as luxury excises that have the same distributional goals (to redistribute from the rich to the poor) but that cannot be gamed in the same way.<sup>182</sup> In other words, to the extent that a high wealth individual has employed legal (or illegal) structures to defer and shelter income,

177 See, eg, the self-imposed cap on government spending as a percentage of GDP (of 23.9%): Josh Frydenberg, 'Budget 2019–20' (Speech, Canberra, 2 April 2019) <<https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/speeches/budget-speech-2019-20>>.

178 See, eg, the *Henry Review*'s recommendation to apply a 40% discount to most interest income, net residential rental property income, capital gains and certain interest expenses, thus slightly reducing the current 50% concessional treatment of capital gains for certain individuals, trusts, small business and eligible superannuation funds but extending it to a broader range of capital income: *Henry Review Detailed Analysis* (n 6) vol 1, 62–85, 70 (recommendation 14). Despite acknowledging the efficiency benefits of taxing wealth in the form of a bequest tax, the *Henry Review* demurred for reasons of political sensitivity: at 137–46, 144 (recommendation 25).

179 Crawford, Keen and Smith (n 168) 284. 'The Ramsey-style results would, therefore, only be relevant where there were constraints on the use of income taxation': Atkinson and Stiglitz (n 172) 74.

180 See, eg, Stiglitz, 'In Praise of Frank Ramsey's Contribution to the Theory of Taxation' (n 173) 243, 247.

181 Joel Slemrod and Shlomo Yitzhaki, 'Tax Avoidance, Evasion, and Administration' in Alan J Auerbach and Martin Feldstein (eds), *Handbook of Public Economics* (North-Holland, 2002) vol 3, 1423, 1447–9; Joel Slemrod, 'The Economic Consequences of Taxing the Rich' in Joel B Slemrod (ed), *Does Atlas Shrug: The Economic Consequences of Taxing the Rich* (Harvard University Press, 2000) 3, 17–19. Diamond and Mirrlees did not factor in tax evasion into their analysis: Diamond and Mirrlees, 'Optimal Taxation and Public Production II' (n 35) 278.

182 Gamage, 'How Should Governments Promote Distributive Justice' (n 123) 3, 39.

then there are efficiency reasons for attempting to get a share of that otherwise taxable income through other tax instruments (including those that might target another base such as consumption). Complementary or alternative taxes might: reduce the incentive to game in the first place by ensuring that any gain will be taxed (albeit once spent and likely at a lower effective rate);<sup>183</sup> ameliorate incentives to substitute leisure for labour;<sup>184</sup> and provide more accurate information on actual economic capacity rather than the taxable capacity minimised by tax gaming.<sup>185</sup> For example, if the trend of increased sales of luxury cars during COVID-19 noted at Part IV(A) was in part a product of increased capacity to spend due to tax minimisation by high wealth individuals, this might lend support for the LCT as a means to better tax the actual economic capacity of the taxpayer who has minimised the income tax but not the LCT. This argument is not without its critics (eg, what of the taxpayer who never buys the luxury car or what if both taxes can be gamed in different ways – then you have just added layers of complexity for little reward).<sup>186</sup> However, 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 something from those with sufficient ability to pay in the absence of major reform but not to give up on the idea of properly reforming the income tax or on relying on other supplementary options such as wealth and transfer taxes.<sup>187</sup> Although there is an obvious fairness rationale to this argument, it is important to note 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 literature on the optimal rate-setting for commodity taxation which shows that a uniform commodity tax rate is not always optimal.<sup>188</sup> Under certain conditions,<sup>189</sup> tax rates might vary according to, for example, 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

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183 Ibid 44.

184 Although you might work less to avoid an income tax on your labour, the excise tax then reaches your expenditure on consumption: *ibid* 43.

185 Ibid 49–50. Gamage highlights additional considerations which add to the case for the use of select excises as including the degree to which tax-gaming generates negative externalities and political economy considerations which include the observation 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 tax instruments: at 65–6, 70–1.

186 Kaplow, *The Theory of Taxation and Public Economics* (n 167) 122.

187 Gamage, 'How Should Governments Promote Distributive Justice' (n 123) 3, 85–6. See also David Gamage, 'The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth' (2015) 68(2) *Tax Law Review* 355.

188 For a good summary of the main contributions, see Crawford, Keen and Smith (n 168) 284–91.

189 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(145) *Economic Journal* 47, 47, 58, 55–60 <<https://doi.org/10.2307/2222721>>. Atkinson and Stiglitz (n 172) 74.

response to taxation (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).<sup>190</sup> Related factors include the substitutability of a taxable good with another (untaxed good) and the extent to which a good is a complement to leisure, with higher rates on goods that are a complement to leisure (eg, a luxury yacht) and lower rates on those that substitute for leisure or complement labour (eg, uniforms).<sup>191</sup>

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 reduce administrative costs and prevent political lobbying and gaming) not by purely economic concerns.<sup>192</sup> 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 when considered from a second-best perspective. 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.<sup>193</sup> First, 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).<sup>194</sup> Second, such taxes are administratively feasible to collect because luxury cars can be precisely defined and categorised while the sheer size of cars

190 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: Ramsey (n 189) 55–60; Crawford, Keen and Smith (n 168) 284–91; William M Gentry, ‘Optimal Taxation’ in Joseph J Cordes, Robert D Ebel and Jane G Gravelle (eds), *The Encyclopedia of Taxation and Tax Policy* (Urban Institute Press, 2nd ed, 1999) 281–3.

191 WJ Corlett and DC Hague, ‘Complementarity and the Excess Burden of Taxation’ (1953) 21(1) *Review of Economic Studies* 21, 21–30 <<https://doi.org/10.2307/2296257>>. See also Slemrod, ‘Optimal Taxation and Optimal Tax Systems’ (n 30) 159; Gentry (n 190) 281–3; Crawford, Keen and Smith (n 168) 289 tbl 4.1. It seems plausible to assume that luxury cars are more likely a complement to leisure rather than labour (unless one drives, sells or services such cars for a living).

192 Crawford, Keen and Smith accept the case for rate differentiation but, for reasons of simplifying administration, prefer a single rate: Crawford, Keen and Smith (n 168) 286, 288–91, 350–1. These include specific concerns around how a Value-Added Tax (‘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): at 350. See also Gamage, ‘How Should Governments Promote Distributive Justice’ (n 123) 51.

193 Sijbren Cnossen, ‘Reform and Coordination of Indirect Taxes in the ASEAN Free Trade Area’ (2013) 69 *Tax Notes International* 589, 609 (‘Reform and Coordination of Indirect Taxes’). Although Cnossen himself concludes that there is no role for luxury excise taxes in Australia (absent externalities) because of the strength of the income tax and transfer system, given this article raises questions about the reliability of that conclusion, one can see that there are in fact theoretical (and empirical) factors in support of the LCT: Sijbren Cnossen, ‘Excise Taxation in Australia’ in Melbourne Institute of Applied Economic and Social Research (ed), *Melbourne Institute: Australia’s Future Tax and Transfer Policy Conference* (University of Melbourne, 2010) 236, 239.

194 Cnossen, ‘Reform and Coordination of Indirect Taxes’ (n 193) 609–10.

and the need to register such vehicles in order to use them means that consumption is more difficult to conceal or shift.<sup>195</sup>

These theoretical benefits are borne out by the empirical analysis in Part IV which demonstrated 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 the timing of purchases when changes are made (as occurred in 2008) or by tax gaming, which can be better addressed by tightening administration and design). This remains the case even though there might be some valid objections to the design and operationalisation of the LCT such as the value threshold at which it applies.<sup>196</sup>

If other commodities exhibit similar features to luxury vehicles – in essence a limited class of luxury assets for which 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 the LCT. Cnossen observes that higher ad valorem taxes on ‘pleasure boats, and private aircraft are appropriate’ for similar reasons.<sup>197</sup> Similarly, there is a case for the taxation of luxury housing, but Cnossen suggests that this is properly done through the property tax system.<sup>198</sup> Press reports suggest that the drafters charged with designing the LCT initially considered extending its application to luxury boats but did not do so.<sup>199</sup> Few would dispute that private yachts and aircraft are an item of luxury expenditure, indeed even Posner agrees that a tax on yachts would probably be progressive but cautions that many goods in heavy demand by the wealthy are those for which demand is elastic.<sup>200</sup> Further theoretical and empirical work may be required to test if extending the base to include such items will perform as well as taxing luxury vehicles. This includes determining how best to manage the distinction between items of personal and business expenditure and assessing whether such items are equally as robust against avoidance (with boats and aircrafts, for example, more readily able to be registered elsewhere).<sup>201</sup> The fate of proposed reforms in Canada

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195 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 luxury taxes on these goods difficult to justify and administratively difficult: *ibid.*

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

197 *Ibid* 610.

198 *Ibid.*

199 Coorey (n 61). 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. As the Canadian proposal shows, 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: see above n 93.

200 Posner (n 7) §18.3.

201 The United States 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 (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, the

to tax luxury vehicles and aircraft (above a threshold of CAD100,000) and boats (above CAD250,000) will be instructive.<sup>202</sup> However, irrespective of the case to extend the base, the theoretical and empirical evidence makes a strong case for a select excise on luxury cars.

## VI ASSESSING THE FAIRNESS OBJECTIONS TO THE LCT

The *Henry Review* further objected to the LCT on fairness grounds arguing that the tax violated principles of vertical equity and horizontal equity, the latter because

[p]eople 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.<sup>203</sup>

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 tastes differ',<sup>204</sup> 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'.<sup>205</sup> 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'.<sup>206</sup>

As was detailed in Part V, elsewhere the *Henry Review* is not committed to taxing everyone equally according to ability as evidenced by the *Henry Review's* preferencing 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 we think there is a good reason to tax people differently on the basis of those preferences.

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effective burden fell on producers rather than consumers and contributed to the decline of the domestic yacht-building industry) or effective political lobbying. See also United States General Accounting Office, *Tax Policy and Administration: Luxury Excise Tax Issues and Estimated Effects* (Report No GGD-92-9, 26 February 1992) 2–7, 32 (noting insufficient data to establish the effects of the tax).

202 'Consultation on the Select Luxury Goods Tax', *Government of Canada* (Web Page, 10 August 2021) <<https://www.canada.ca/en/departement-finance/programmes/consultations/2021/consultation-proposed-luxury-tax/select-luxury-goods-tax.html>>.

203 *Henry Review Detailed Analysis* (n 6) vol 2, 475. See also *Senate Committee Report on Luxury Car Tax 2008* (n 53) 23.

204 Atkinson and Stiglitz (n 172) 70.

205 Ibid 73.

206 AC Pigou, *A Study in Public Finance* (Macmillan, 3<sup>rd</sup> ed, 1947) 77.

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

[v]ery 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.<sup>207</sup>

Once again, the superficial appeal of such an objection does not withstand closer scrutiny. The claim that ‘price is an arbitrary proxy for luxury’ seems an overstatement and appears to undermine the *Henry Review*’s otherwise steadfast commitment to the efficiency of markets. As Part V highlighted, expensive luxury cars are exactly the type of good that tends 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,<sup>208</sup> this objection can be addressed by design, in particular, at the appropriate setting of the threshold at which the tax applies. If set appropriately to clearly include 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 economic justice according to vertical and horizontal equity,<sup>209</sup> then there are further reasons for specifically taxing the select expenditure of the rich. The remainder of this Part highlights some relevant arguments made within a vast and contested theoretical literature.<sup>210</sup> 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, the availability of alternatives and substitutes etc.<sup>211</sup> The choice to exercise that capacity by spending on specific items of consumption (or certain

207 *Henry Review Detailed Analysis* (n 6) vol 2, 475.

208 In passing, it is worth noting that a quick review of the top five selling seven-seater people-mover vans in Australia showed that the majority of models fall below the LCTT: ‘Top 5 People Movers under \$60k’, *Drive* (Web Page, 2022) <<https://www.caradvice.com.au/top-5/people-movers/>>.

209 Murphy and Nagel (n 10) 13–16.

210 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* (Princeton University Press, 2011) 81, 81–115.

211 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: National and Global Issues* (Springer, 2015) 101, 115.



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,<sup>212</sup> 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 contributes to advancing social standing (but welfare loss).<sup>213</sup>

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.<sup>214</sup> 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.<sup>215</sup> Importantly, for Rawls this is not a matter of envy (as Posner contends) but one of facilitating the reciprocity required to support social cohesion.<sup>216</sup>

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 examples such as the use of Black slaves as domestic servants in the southern states of the United States (or in Australia) or the replacement of 40% of South Asia's rainforests with plantations for cash crops.<sup>217</sup> In the context of cars, few could dispute the resource intensity required to produce a car. Although an LCT

212 '[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 H Frank, 'Should Public Policy Respond to Positional Externalities?' (2008) 92(8) *Journal of Public Economics* 1777, 1777 <<https://doi.org/10.1016/j.jpubeco.2008.03.001>>.

213 Ibid 1777–9; Robert H 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 leads Frank to favour a progressive consumption tax levied on the individual (consisting of income minus savings with the balance taxed at progressive rates). However, this policy prescription is not inevitably tied to the problem he identifies: ibid 1783–5. Robert H Frank, *Falling Behind: How Rising Inequality Harms the Middle Class* (University of California Press, 2013) ch 11.

214 John Rawls, *Justice as Fairness: A Restatement*, ed Erin Kelly (Belknap Press, 2001) 6, 76–7, 122–4 ('Justice as Fairness'); Rawls, *A Theory of Justice* (n 40) 89.

215 Rawls, *A Theory of Justice* (n 40) 154–5, 447–8.

216 Ibid 464–74; Rawls, *Justice as Fairness* (n 214) 195–7. Cf Posner (n 7) §17.2; Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* (Harvard University Press, 2000) 66–8.

217 See, eg, Thavolia Glymph, *Out of the House of Bondage: The Transformation of the Plantation Household* (Cambridge University Press, 2008); Inara Walden, "'That Was Slavery Days': Aboriginal Domestic Servants in New South Wales in the Twentieth Century' [1995] (69) *Labour History* 196 <<https://doi.org/10.2307/27516399>>; Matheus Henrique Nunes et al, 'Recovery of Logged Forest Fragments in a Human-Modified Tropical Landscape during the 2015–16 El Niño' (2021) 12 *Nature Communications* 1526:1–11 <<https://doi.org/10.1038/s41467-020-20811-y>>.

levied in one rich nation cannot address this inequity,<sup>218</sup> the point serves to highlight the extremely limited conception of justice adopted by the *Henry Review* when assessing fairness from such a narrow framing of vertical and horizontal equity.

When 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 combined appeal to more broadly conceived ideas of justice and to the notion of the second-best – 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 we should).<sup>219</sup>

## VII CONCLUSION

One can think of few closer bedfellows than law and economics and taxation for sharing an enthusiastic embrace of efficiency as a principle of legal design. However, as this article has demonstrated, either on the narrow definition of efficiency as espoused by law and economics or on the broader definition used in optimal tax theory, the approach has a number of limitations. First, efficiency is too reductive a guide to govern the complex normative issues of economic justice that taxation gives rise to. This is particularly acute in the failure of law and economics to give sufficient priority to redistribution. Moreover, the limits of the relative valuing of redistribution in optimal tax theory models means that the prescriptions it offers bear little resemblance and offer little guide to real-world tax systems which, by virtue of their historical and institutional context, are of necessity second-best. As Raskolnikov contends:

Recognizing the limits of tax law and economics reveals an additional weakness of this approach. The fundamental reason for these limits is the optimal tax theory's failure to incorporate distributive considerations in a manner that reflects some deeply and widely held beliefs. Given the theory's limitations, a suggestion that wide swaths of the actual tax system should be designed while ignoring redistribution because that is what the theory prescribes does not appear to be particularly persuasive. Why should we rely on one of the theory's central conclusions if we cannot rely on the theory's overall results?<sup>220</sup>

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218 For proposals that do try to address the global distributional issues, Pogge proposes a global resources dividend – a tax levied on the sale and extraction of natural resources to fund the global poor to meet their basic needs with dignity: see, eg, Thomas Pogge, *World Poverty and Human Rights: Cosmopolitan Responsibilities and Reforms* (Polity Press, 2<sup>nd</sup> ed, 2008) 202–21; Timothy Mawe and Vittorio Bufacchi, 'The Global Luxuries Tax' in Helmut P Gaisbauer, Gottfried Schweiger and Clemens Sedmak (eds), *Philosophical Explorations of Taxation and Justice: National and Global Issues* (Springer, 2015) 203 propose a global levy on the sale of luxury goods and services to contribute to a Global Poverty Fund to alleviate the worst cases of global poverty.

219 A 2020 PricewaterhouseCoopers report suggests introducing a luxury rate into the GST to address regressivity issues: PricewaterhouseCoopers, *Where Next for Australia's Tax System: How GST Reform Can Help Reboot Prosperity for Australia* (Report, July 2020) 15.

220 Raskolnikov (n 1) 571.

The campaign to repeal the LCT offers an ideal example of the limitations of the law and economics approach to taxation. The calls to repeal could be drawn straight from a law and economics playbook – they are firmly grounded in a narrow appeal to economic efficiency and an inadequate appeal to fairness or redistribution. While the LCT might not be a first- or even second-best option from an efficiency point of view, its retention has merit on a number of bases which include revenue-generation relative to cost as well as a broad appeal to fairness. That is, the LCT does some good and little harm. These rationales have informed the deeper history of the LCT in Australia as well as the taxation of luxury cars elsewhere. It is a strange claim that the only yardstick by which we should judge the LCT is set at a particular point in time (when comparisons could be made between the GST and the WST or at a time when we once manufactured cars in Australia). Importantly, the LCT offers a rare example of the law having a positive impact on the tax's economic performance resulting from the incorporation of the LCT into the legal design and administration of the GST and from it falling on a small number of well-resourced taxpayers with good capacity to comply and with few (although not nil) opportunities to avoid the tax.

The conclusion that the LCT has sufficient merit to warrant its retention and/or possible expansion applies despite the theoretical critique of the *Henry Review* that the tax is both inefficient (ie, distortive) and unfair. Part V showed that the *Henry Review*'s recommendation to repeal the LCT is predicated on the assumption of system-wide reform or on assuming the superior redistributive capacity of the income tax and transfer system. However, this article disputes this assumption given current theoretical preferences (including those espoused by the *Henry Review*) and practice. These trends suggest a weakening rather than strengthening of the redistributive capacity of the income tax as a result of legislative intent (such as the reduction and compression of marginal tax rates) and permissive neglect (such as a system which facilitates tax gaming through trusts and corporate shelters) which particularly hampers tax collection from the top end. In this second-best context, there is a general claim to be made on efficiency grounds for retaining the LCT as a supplement to the income tax. The case for retention is bolstered by the theoretical and empirical evidence showing that expenditure on luxury cars tends to be the preserve of the rich whose consumption of such items is relatively inelastic, with the tax proving relatively robust to evasion and avoidance.

Part VI challenged the narrow articulation of unfairness by the *Henry Review* and pointed to the manner in which such questions of justice need to extend beyond simply judging 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 upon, social cooperation and cohesion offers a basis for taxing the conspicuous consumption of the rich, especially at a time of growing inequality and need.

The second-best case for the retention of the LCT and its possible expansion is of necessity a qualified one. An assessment of the relative efficiency and fairness of the tax might change based on taxpayer behaviour or on the prospect of large-scale reform of the income tax and transfer system in a manner that better balances efficiency and redistribution (especially from the top end). However, in the likely

event that such fundamental reform will not be forthcoming (given the pro-consumption tax position adopted by the *Henry Review* and legislated reforms (and failure to reform) to date), there is merit in retaining the LCT despite the claims of the car industry representatives who oppose it.

In arriving at these conclusions, this article makes a number of important contributions to the discipline of law and economics as it applies to questions of taxation. First, it provides an interesting case study on the salience of second-best solutions for economic justice. The tax, which arose more from political need than from adherence to mainstream public finance theory, has been successful in achieving its goals – at raising a modest amount of revenue from the sale of luxury cars at an appropriately low level of administrative and compliance costs. Second, it shows the limits of arguments for reform that proceed at the level of economic theory without taking sufficient account of the empirical reality of legal implementation – in this instance, this amounts to overstating the theoretical inefficiency of the LCT and understating the actual efficiency of its performance. It is also emblematic of the largely underdeveloped nature of law and economic analysis to questions of taxation in Australia whereby the theoretical economic merits of a particular policy or reform are overemphasised (and oversimplified) and the role of legal institutions in shaping actual outcomes are under-emphasised or ignored. Finally, it highlights the limitations of economic efficiency as a criterion of economic justice by demonstrating that there are reasons beyond the mere maximisation of individual welfare for addressing pressing and persistent issues of wealth and income inequality which go to the heart of what makes a good society from which we all benefit.