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EXPOSURE DRAFT EXPLANATORY MATERIALS – SIMPLIFYING  
WORK-RELATED CAR EXPENSES

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EXPOSURE DRAFT



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## ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
Commissioner	Commissioner of Taxation
FBTAA 1986	<i>Fringe Benefits Tax Assessment Act 1986</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITAR 1997	<i>Income Tax Assessment Regulations 1997</i>

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## **Chapter 1**

# **Simplifying work-related car expenses**

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### **Outline of chapter**

1.1 Schedule # to this Bill simplifies and modernises the methods for calculating work-related car expense deductions. Currently, taxpayers have an option of using one of four methods to determine their work-related car expense deductions.

1.2 These methods, each with differing compliance obligations, are:

- 12 per cent of original value method;
- one-third of actual expenses method;
- cents per kilometre; and
- logbook method.

1.3 Schedule # will repeal the 12 per cent of original value method and the one-third of actual expenses method.

1.4 Further, this Schedule will provide a streamlined process for calculating the cents per kilometre method by providing a single rate of deduction which more accurately reflects the actual running expenses of a vehicle.

### **Context of amendments**

1.1 Taxpayers are allowed a deduction for the costs associated with operating a motor vehicle in the course of deriving assessable income or in carrying on a business. However, the current methodology used to determine these deductions does not necessarily reflect the costs of running a motor vehicle.

1.2 Of the four methods available for taxpayers to calculate their work-related car expense deductions, three are considered to be somewhat arbitrary. The 12 per cent of original value method, the one-third of actual expenses method and the cents per kilometre method, applying to business travel up to 5,000 kilometres, do not accurately reflect the actual running costs of cars. The fourth method is more substantive: the logbook method.



1.3 These changes will tighten the nexus between actual expenses and the allowable deduction by removing the more arbitrary methods and providing a single rate for the cents per kilometre deduction. Rather than providing taxpayers with an option of choosing between four methods and basing their choice on the method which generates the highest deduction for them, the new arrangements will still enable choice, however the outcome will more closely align with the actual costs associated with work-related car use.

1.4 These changes are not expected to adversely affect the vast majority of taxpayers who currently utilise the two methods which will be retained; the cents per kilometre method and the logbook method. Based on the *ATO 2011-12 Taxation Statistics*, the removal of the 12 per cent of original value and one-third of actual expenses methods is expected to affect only 2 per cent of taxpayers.

1.5 The current cents per kilometre rates are based on the engine capacity of the vehicle being driven. The law provides for three cents per kilometre rates applying to vehicles with ordinary engines. Those cars with an engine capacity of up to 1.6L claim 65 cents per litre; taxpayers whose vehicle engine capacity is between 1.601L and 2.6L claim a rate of 76 cents per litre; and the third rate of 77 cents per litre applies to vehicles with an engine capacity of above 2.601L.

1.6 The cents per kilometre method was introduced in the 1980s as an arbitrary method to determine deductions for employee car expenses which reduced compliance cost associated with substantiating work-related car expenses. The three cents per kilometre rates were based on the private motor vehicle allowances paid to Australian public service officers as determined by the Public Service Board. Since introduction, the rates have been indexed by movements in the private motoring subgroup of the consumer price index.

1.7 Since the 1980s there have been major changes to the design of cars including the introduction of hybrid and electric cars and, as such, the operating costs have also changed. Data from peak motoring bodies such as the NRMA and RACQ indicates that the average per kilometre running cost of the top five selling cars (a mix of small to large cars) in Australia is 66 cents. This is much lower than the current rate applying to medium and large vehicles.

1.8 As these rates do not reflect the operating cost of cars, transferring the setting of the rate to the Commissioner of Taxation (Commissioner) will ensure the rate better reflects the operating cost of a vehicle. The rate will also be set at beginning of the tax year rather than at the end of the year as occurs under the current legislation. As a result,

taxpayers will be able to make more informed choices at the commencement of the income year.

1.9 Further, the changes to the cents per kilometre method will enable taxpayers who drive electric and hybrid cars to access the cents per kilometre method as those cars do not qualify to use the current rates that are based on rotary engine size.

## Summary of new law

1.10 This Schedule amends the law applying to work related car expenses by removing the two least used options.

1.11 Subdivision 28-D of the ITAA 1997, containing the 12 per cent of original value method, will be repealed. This method allowed taxpayers to claim a deduction for their work-related car expenses at a rate of 12 per cent of the original value of the vehicle, or 12 per cent of the market value of the vehicle when you first began to lease it. *[Schedule #, item 3, subdivisions 28-D and 28-E of the ITAA 1997]*

1.12 The Schedule also removes Subdivision 28-E of the ITAA 1997 which contained the one-third of actual expenses method. To use this method, taxpayers deduct one-third of each car expense that qualifies for a deduction under another provision of the ITAA 1997, or it would qualify, had the car only been used in producing assessable income. *[Schedule #, item 3, subdivisions 28-D and 28-E of the ITAA 1997]*

1.13 This Schedule will simplify the cents per kilometre method by providing a single cents per kilometre rate for the 2015-16 income year. Taxpayers will continue to be able to choose to apply the cents per kilometre method (for up to 5,000 business kilometres travelled), or the logbook method, depending on which method they feel best captures the actual running costs of their vehicle.

1.14 In the 2015-16 income year the cents per kilometre rate will be set at 66 cents per kilometre. The Commissioner will be provided with the power to set the cents per kilometre rate for future years via legislative instrument. *[Schedule #, item 44, transitional – initial rate of cents per kilometre of the ITAA 1997]*

1.15 The Schedule makes other consequential amendments to the ITAA 1997 to remove reference to the repealed Subdivisions 28-D and 28-E. *[Schedule #, items 21 to 42, section 12-5 (table item headed “car expenses”) to subsection 900-250(4) of the ITAA 1997]*

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The law will contain two methods for calculating your work-related car expense deduction; the logbook method and the cents per kilometre method.	The law currently provides four methods for calculating your work-related car expense deduction; the 12 per cent of original value method, the one third of actual expenses method, the logbook method and the cents per kilometre method.
<p>The new law will provide for a single rate of deduction and provide the Commissioner of Taxation with authority to set the cents per kilometre rate, taking in to account the average operating costs of a vehicle.</p> <p>The Commissioner will consider factors including the fixed costs, such as depreciation, registration and insurance as well as variable costs including maintenance, repairs and fuel costs of running a vehicle.</p> <p>The Commissioner will publish the cents per kilometre rate in a legislative instrument.</p>	<p>The current cents per kilometre calculation rate is determined by reference to a vehicle's engine capacity.</p> <p>There are three rates under the current law applying to vehicles with an engine capacity of up to 1.6 litres; between 1.601 litres and 2.6 litres and an engine capacity greater than 2.601 litres.</p> <p>This rate is indexed to movements in the private motoring sub-group of the CPI.</p>

## Detailed explanation of new law

1.16 By repealing Subdivision 28-D, taxpayers who relied on the 12 per cent of original value method will now have a choice of using the cents per kilometre method or the logbook method, depending on which method best reflects the cost of running their vehicle.

1.17 The 12 per cent of original value method required taxpayers to determine the cost of their vehicle when they acquired it or 12 per cent of the market value when the vehicle was first leased. If the vehicle was only owned for part of a year, the deduction would be reduced to reflect the percentage of the year the vehicle had been owned or leased. [*Schedule #, item 3, subdivisions 28-D and 28-E ITAA of the 1997*]

1.18 The repeal of Subdivision 28-E removes the option to claim a deduction for work-related car expenses using the one-third of actual expenses method. The one-third of actual expenses method applies to expenses that are otherwise deductible under the ITAA 1997 or expenses

that would qualify, had the vehicle been used only in producing assessable income.

1.19 If only part of an expense qualified for deduction under another method, one-third of that part is deductible under Subdivision 28-E. In addition, for a deduction to be claimed under this Subdivision, over 5,000 business kilometres must have been travelled in the relevant income year. The complexity of this method made it one of the least utilised methods.

1.20 By repealing these provisions, this Schedule removes these two arbitrary methods of determining a deduction for work-related car expenses. *[Schedule #, item 3, subdivisions 28-D and 28-E of the ITAA 1997]*

1.21 This Schedule also simplifies the cents per kilometre method by removing the three rates which were set according to the engine capacity of the taxpayers' vehicle. The new law will provide for a single rate of cents per kilometre in the first year with flexibility for the Commissioner to consider whether a further rate or rates would be appropriate for future years. *[Schedule #, item 1, subsection 28-25(1) of the ITAA 1997]*

1.22 The Commissioner is to set the rate taking into account the average running costs of a car. The Commissioner should consider the fixed and variable costs of operating a vehicle including such matters as fuel costs, servicing costs and the cost of replacing tyres, registration and insurance expenses. The Commissioner, at his or her discretion, may determine more than one rate if he or she wishes to set different rates for different classes of car in future income years. *[Schedule #, item 2, at the end of section 28-25 of the ITAA 1997]*

1.23 By providing the Commissioner with the power to set the cents per kilometre rate, the Commissioner will be able to ensure that the rate better reflects the average running expenses of cars and publication of the rate at the beginning of the income year will enable taxpayers to make a more informed choice between the logbook or cents per kilometre method, depending on which method they feel better captures the running costs of their vehicle.

1.24 The Commissioner will publish his or her determination in a legislative instrument. *[Schedule #, item 2, at the end of section 28-25 of the ITAA 1997]*

1.25 These changes may also affect the way untaxed allowances are calculated. For example, if an employer currently pays their employee an allowance in respect of their motor vehicle use and the allowance is calculated using one of the methods which will be repealed by this Schedule, the employer will need to update the method of calculating the allowance.

1.26 Further, if the rate of the allowance paid by an employer is higher than 0.66 cents per kilometre, then the employee will need to report this allowance in their tax return. The employee will be entitled to claim a deduction for the amount, up to 0.66 cents per kilometre and be subject to tax on amounts exceeding 0.66 cents per kilometre. Alternatively, an employee may utilise the logbook method to claim for their work-related car expenses.

## Consequential amendments

1.27 Consequential amendments are required to the ITAA 1997 to remove reference to the repealed Subdivisions 28-D and 28-E. Section 28-12 will be amended to remove reference to the ‘four methods’, and will retain reference to the remaining two methods only; those being the cent per kilometre rate method and the logbook method. [Schedule #, items 21 to 42, section 12-5 (table item headed “car expenses”) to subsection 900-250(4) of the ITAA 1997]

1.28 Subsection 40-25(6) of the ITAA 1997 will be repealed as it refers to the one third of actual expenses method. [Schedule #, item 31, subsection 40-25(6) of the ITAA 1997]

1.29 Section 40-55 of the ITAA 1997 will be amended to remove reference to the repealed 12 per cent of original value method in the section. [Schedule #, item 32, section 40-55 of the ITAA 1997]

1.30 Other references to the repealed Subdivisions will be removed from the ITAA 1997.

1.31 Consequential amendments will also be made to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) to remove reference to the repealed methods.

1.32 This Schedule removes certain provisions within the FBTAA 1986 which relate to the one-third of actual expenses method of deducting an employee’s work-related car expenses (if the employee had claimed the deduction under income tax) from the provisions relating to the otherwise deductible rule. [Schedule #, item 6, 10, 14 and 18, paragraph 19(1)(h), paragraph 24(1)(k), paragraph 44(1)(j) and paragraph 52(1)(j) of the FBTAA 1986]

1.33 For example, section 19 of the FBTAA applies in order to enable an employer to calculate the amount of fringe benefit provided to an employee where the employee has received a loan fringe benefit. In the context of the amendments this Schedule makes to the income tax laws, it is important to ensure consistency between methods available to

determine an employee's deductions under income tax law and the calculation of an employer's expense under the fringe benefits tax laws.

1.34 These amendments mean an employer will continue to be able to apply the otherwise deductible rule for work-related car expenses using the 'logbook method', for example in paragraph 19(1)(f). If logbooks have not been maintained an employer can apply the otherwise deductible rule by using the remaining 'business use declaration method', for example in paragraph 19(1)(g) which provides a deduction based on the business use of the car which is capped at 33.33 per cent of the value of the fringe benefit.

1.35 References to the previous declaration method that provided a fixed 33.33 per cent reduction, based on a car exceeding 96 business kilometres a week, will be removed. *[Schedule #, item 5, 9 and 13 and 17, subparagraph 19(1)(g)(ii), subparagraph 24(1)(j)(ii), subparagraph 44(1)(h)(ii) and subparagraph 52(1)(h)(ii) of the FBTA 1986]*

1.36 These amendments do not affect car fringe benefits and are limited to reimbursement for expenses incurred in work-related use of a private motor vehicle.

## **Application and transitional provisions**

1.37 The rate set for the 2015-16 income year will be determined as 66 cents per kilometre. The Commissioner will determine the rate for later income years. *[Schedule #, item 44, transitional – initial rate of cents per kilometre of the ITAA 1997]*

1.38 Changes to the FBTA 1986 will operate from 1 April 2016 and later FBT years. *[Schedule #, item 43, application of amendments of the ITAA 1997 and of the FBTA 1986]*