

The Cycling Promotion Fund



Submission to the Review of Australia's Future Tax System

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Introduction

The Cycling Promotion Fund, an initiative of the Bicycle Industry in Australia, is pleased to provide a submission in response to questions raised in the *Consultation Paper*, released by the Tax Review panel in December 2008.

Cycling Promotion Fund (CPF) membership is open to any business, which imports, manufactures or wholesales bicycle products, and/or provides services to the point of sale sector of the bicycle industry and supports its mission.

The CPF provides a range of services to the bicycle sector and cycling groups and undertakes a range of activities to promote cycling as an active transport solution that can help improve efficiencies in the transport sector, address climate change, traffic congestion, and public health concerns.

Achievements of the CPF in the provision of evidence-based research include the federally funded health study 'Cycling>Getting Australia Moving', evidence overview 'Cycling>Moving Australia Forward' and numerous fact sheets and promotional documents.

An expert advisory committee and national alliances across the health, public transport and bicycle user sectors ensure that CPF policy is aligned with best practice to achieve the best outcomes for all Australians.

Our aim is to ensure that investment in cycling is regarded as a cost effective way to:

- increase mobility,
- make recreation accessible,
- increase physical activity levels,
- boost regional tourism and
- enable Australians to win medals at the elite sporting level;

And that Cycling is held in high regard at all levels of Government as a way to improve the quality of life for all Australians.

The Cycling Promotion Fund made a submission to the Tax Review in October 2008.

Summary

This submission focuses specifically on questions 1 & 3 outlined in Section 12 of the *Consultation Paper*, namely:

- Q1. How can motor vehicle related taxes and road funding arrangements be designed to improve the efficiency of transport of people and goods in Australia?
- Q3. Do the existing tax arrangements lead people to make economically inefficient transport choices, and if so, how might they be improved?

Both questions will be considered together in this submission.

Key points in this submission

1. Elements of the current tax system that arbitrarily favour one mode of transportation over another result in inefficient allocation of resources. These distortions should be identified and removed (Part I).
 2. The current Fringe Benefit Tax (FBT) system as it relates to motor vehicles creates market distortions by changing driver behaviour as they drive more in order to preserve the benefit (Part I).
 3. The Fringe Benefit Tax arrangements for motor vehicles should be modified and scaled back over time to ensure this tax does not distort decisions in a manner that increases unnecessary car travel (Part I).
 4. Increased levels of avoidable or unnecessary car travel exacerbate problems for transport system efficiency, the environment, population health, social well being and has a negative impact on a range of key government priorities (Part II).
 5. A range of tax incentives should be considered to encourage and diversify transport choice towards sustainable transport modes such as cycling and public transport. Such treatment should be justified on the broad range of benefits it would provide in the areas of employment creation, health, social welfare and inclusion, environmental and transport system efficiency (Part III).
- A number of countries, including the UK and the US have begun specific taxation incentives to encourage bicycle use as well as other financial initiatives to diversify transport choice. We encourage the Tax Review to assess how these tax arrangements may be integrated into Australia's tax system.

I. Fringe Benefits Tax and induced distortions, including driver behaviour

The Fringe Benefit Tax and Motor Vehicles Fringe Benefits Tax (FBT) arrangement is costly, inefficient and distorts fundamental choices we make. The cost of the current system in the 2008/09 was \$1.6 billion and this is forecast to rise to \$2.01 billion in 2009/10 (Treasury, 2007).

The current system of FBT in Australia has been the subject of much debate and criticism in relation to economic inefficiencies; inequities and the increasing compliance burden (see Institute of Chartered Accountants in Australia (ICAA) (2006) for a more detailed discussion).

The CPF notes that the FBT concession for motor vehicles is the most common type of fringe benefit and the source of approximately half of all FBT revenue (ICAA, 2006). The distance-based reductions to the statutory rate, which is overwhelmingly the more frequently used of the two methods for calculating FBT on cars, collects approximately 96 per cent of all FBT on motor vehicles (ICAA, 2006).

Despite its administrative simplicity, there are two distinct sources of inefficiencies (problems) in the current statutory formula method:

1. the general concessionary nature of FBT favours motor vehicles over other forms of transport; and
2. the distorting incentives provided by the distance based thresholds used in the current formula.

Problem 1: Concessions for motor vehicles

The statutory formula method was introduced primarily to eliminate the need for recipients of motor vehicle related fringe benefits to log all travel in order to determine the proportion of private versus business related travel (as required under the alternative operating cost method). However, according to the ICAA (2006) the statutory formula method was also adopted “as an indirect method of providing support for the domestic motor vehicle construction sector, which in 1986 (when FBT was introduced) was attracting substantial Government support to improve its economic viability”.

Supporting analysis by the ICAA (2006) based on ATO and Treasury data indicates that, by using the statutory formula method, approximately 43.1 per cent of potential FBT on cars was foregone in 2003-04. This translates to an annual subsidy of more than \$1 billion, with both the total revenue and percentage foregone increasing over time. The basic reason is that the statutory percentages are too low and do not adequately reflect the real proportions of private versus business travel.

This \$1 billion subsidy for motor vehicles results in allocative inefficiencies in transport related investment decisions involving cars and alternative options such as bicycles and public transport, which do not receive any FBT concessions. Inefficient over-consumption of cars leads to inefficient car use and inefficient allocation of car inputs such as fuel—which exacerbates problems with un-priced third-party externalities such as congestion and greenhouse gas emissions.

As such, the CPF encourages the Review Panel to address the distorting and environmentally damaging nature of the current statutory method by modifying or phasing out these concessions. Our view is supported by a diverse range of stakeholders including the ICAA (2006) which points out that, as a result of the changing nature of the domestic motor vehicle industry (with more Australian made cars being exported, and increased car imports as a result of tariff reductions), more than half of the FBT concessions are benefiting overseas importers, rather than the domestic industry and this proportion is increasing over time.

FBT concessions are therefore now a very indirect and poorly targeted means of achieving this policy objective. Replacing the current method with a direct and targeted subsidy for the domestic industry could save approximately \$500 million per year (ICAA 2006).

Problem 2: Distance-based thresholds

In addition to the overall concessions that favour motor vehicles over other forms of transport, there is an incentive for cars to be driven greater distances in order to obtain significant further tax reductions—resulting in further inefficiencies in the allocation of car inputs such as fuel and in relation to transport related decisions involving cars and alternative options such as bicycles and public transport. Increased car use also exacerbates the problems with un-priced third-party externalities such as congestion and greenhouse gas emissions as outlined above.

The CPF encourages the Review Panel to address the distorting and environmentally damaging nature of the current statutory method and outlines a simple alternative statutory method for your consideration as part of the broader review of FBT.

Issues with the current thresholds in the statutory formula method

Using the statutory formula method, FBT payable on a car is based on the ‘taxable value’ of the car multiplied by the FBT rate (currently 46.5%) (ATO, 2008). However the ‘taxable value’ of the car is based on its actual base value multiplied by the ‘statutory percentage’.

This ‘statutory percentage’ declines in discrete amounts at certain thresholds, providing significant savings in FBT once each threshold is reached. For example, assume that a car valued at \$35,000 is used privately, or available for private use for the full tax year, with no after tax employee contributions. In this case, the FBT payable decreases from \$8,736 to \$6,720 as soon as the distance driven exceeds 15,000 km, representing a total saving of over \$2,000, or a 23 per cent discount.

Similarly, the FBT payable on the same car decreases from \$6,720 to \$3,696 as soon as the distance driven exceeds 25,000 km, representing a total saving of over \$3,000, or an additional 45 per cent discount. This threshold provides the largest percentage discount and is also likely to provide an incentive to a large number of recipients, considering that the average annual vehicle travel is approximately 15,500 – 16,000 km (BTCE 1996).

FBT payable under the statutory formula method

Annual distance travelled (km)	Statutory percentage	FBT payable on car valued at \$35,000	FBT payable on car valued at \$70,000
Less than 15,000	26%	\$8,736	\$17,473
15,000-24,999	20%	\$6,720	\$13,440
25,000-40,000	11%	\$3,696	\$7,392
40,000+	7%	\$2,352	\$4,704

Source: ATO, 2008

It is acknowledged that these thresholds will not affect the driving decisions of all recipients of FBT concessions on cars. However, the current structure is widely recognised as providing a strong incentive for many drivers and is highly distorting as they approach each threshold.

By simply trading off fuel costs for additional FBT concessions, it is clear that the perverse incentives are significant. For example, if fuel costs were in the order of \$150 for an additional 1,000 kilometres, then it would not be surprising that savings in the order of several thousand dollars are sufficient to prompt unnecessary increases in vehicle kilometres and associated greenhouse gas emissions.

Anecdotal evidence suggests that many recipients do indeed make long unnecessary trips to reach the next threshold, particularly during the period approaching the end of the FBT year, which is 31st March. For example, Taxpayers Australia (2008) states:

You cannot blame taxpayers who have employer-provided vehicles for clocking up additional kilometres to take advantage of these outdated rules. The savings far outweigh the additional cost, resulting in what some observers call the last month of the FBT year ... "March Madness".

The Ralph Report (1999) found that: Because the taxable value of the benefit under the current formula actually falls by substantial steps as total kilometres rise, there can be a significant incentive to travel unnecessary kilometres toward the end of the fringe benefits year. In consultations, mention was made of the 'March Corporate Rally', a term used to describe the excessive car travel that takes place around the end of March each year.

In a statement to the Australian Senate, Kerry Nettle (2003), an Australian Greens Senator for NSW, provided an example of how fringe benefits tax encourages further driving, using the example of the Fairfield Council in NSW:

Fairfield Council offers its staff cars as a part of their salary package. It requires its staff to travel 25,000 kilometres each year in order to reach a lower tax rate. So Fairfield Council sets out the monthly mileage that a staff member has to travel to reach the annual 25,000kilometre target. It works out at about 2,000 kilometres a month, or 67 kilometres each and every day, which is the equivalent of travelling from Parliament House to Queanbeyan and back three times a day.

Other reports and evidence referring to the 'March Madness' induced by the statutory formula method include several submissions to the recent Australian Government reviews including the Garnaut Climate Change Review (2008), the Standing Committee on Rural and Regional Affairs and Transport (2007) Australia's Future Oil Supply and Alternative Transport Fuels, and the House Standing Committee on Environment and Heritage (HSCEH) Inquiry on Sustainable Cities (2005). The issue with the thresholds has also been raised in reports by The Australia Institute (2001), and the Institute of Chartered Accountants (2006). The HSCEH (2005) report found that "salary sacrificing for a car means that the more kilometres a person travels in an FBT year, the less tax is assessed" and that this represents "one of the impediments to reducing car dependency on Australia roads".

The (HSCEH) committee recommends that the Australian Government review the current FBT concessions for car use with a view to removing incentives for greater car use and extending incentives to other modes of transport.

A statistical analysis of a sample of FBT claims could be used to quantitatively estimate the distorting impact of the thresholds. The resultant distribution is expected to find a disproportionate number of recipients with reported usage just above each threshold compared to just below each threshold, whereas a non-distorting tax would be expected to display a smoother distribution.

Other transport-related problems with the existing tax system

In addition to the FBT concessions on motor vehicles, there are a number of other widely documented problems with the tax system, including:

- tax free fringe benefits for employer-provided car parking;
- poorly targeted differential treatment of import duty on four wheel drive vehicles, which are now largely used in urban areas (see Raimond 2007); and
- state-based fuel subsidies.

None of these tax incentives and subsidies can be utilised for public transport or cycling. They are distorting, add complexity to the tax system and should be reformed or removed.

Recommendations:

1. *The Motor Vehicle Fringe Benefit Tax concession should be modified and scaled back over time.*
2. *The considerable savings that would result from scaling back or removing the Motor Vehicle FBT concessions should be transferred to fiscal policy initiatives that help create a diversified mix of transport options – through public transport and cycling infrastructure investment.*

II. Negative impacts of FBT concessions on a range of government priority areas

Transport usage and investment decisions are closely related with a number of increasingly critical issues facing Australia, including economic activity, climate change, congestion, public health and obesity, and air and noise pollution. These problems pose a significant cost on the Australian community:

Economic activity

While it has been argued that the FBT concessions are important to maintain economic activity within the motor vehicle and related industry sectors (motor industry submissions to first round of tax inquiry), this ignores the fact that motor vehicle use imposes significant external costs (costs not borne directly by users) (Litman 1999). Investment in alternative modes tends to reduce total motor vehicle traffic and associated costs, providing additional long-term economic savings (Litman 2009).

Climate change

In 2006 transport contributed 79.1 Mt CO₂e or 13.7 per cent of Australia's net emissions. Emissions from the transport sector were 27.4 per cent higher in 2006 than in 1990 (Commonwealth of Australia 2008). At a carbon price ranging from \$25 - \$50 per tonne CO₂e, this is equivalent to a cost of approximately \$2 - \$4 billion per annum. The Australian Government Department of Climate Change (2008) has recently documented the potential impacts and costs of climate change. They forecast transport emissions to increase 67% by 2020 – despite the Government's target of an overall 5 – 15% emissions reduction.

Traffic congestion

According to the Bureau of Transport and Regional Economics (2007), congestion costs in Australia's major cities are currently estimated at \$9.4 billion annually and this cost is expected to rise to over \$20 billion by 2020.

Obesity

The Australian Institute of Health and Welfare (2006) found that around half of the Australian population lack the appropriate level of physical activity, a major cause of obesity. Access Economics (2008) estimated the economic cost of obesity at approximately \$58.2 billion annually. Motor vehicle use is closely correlated with obesity rates (Frank et al 2004; Frank et al 2007).

Air and noise pollution

Non-greenhouse emissions from motor vehicles also produce a range of pollutants that produce harmful effects human health and the environment. Laird et al (2001) estimate the costs of health damage from transport-related air and noise pollution at more than \$3 billion per annum. Hamilton and Denniss (2000) estimated the annual costs of urban air pollution (due predominantly to transportation) at over \$13 billion.

III. Role of Tax System reform in addressing key government priorities

International and Australian experience has shown that tax system reform and other market-based instruments can be used to address key priorities and encourage more socially optimal outcomes, including through the direct encouragement of sustainable and active transport alternatives (for examples, see Potter *et al* 2005; Potter *et al* 2006; Commission of European Communities 1998; HM Treasury 2002; The Australia Institute 2001).

While tax reform can play an important role, it must be combined with direct government funding of high priority public transport and cycling infrastructure, as well as effective regulation and planning. The key public policy issue becomes one of designing an appropriate set of mechanisms that address contemporary problems such as climate change in a direct, proportionate and cost-effective manner.

Economic efficiency

In considering the reform options for the tax system, one of the key criteria that should be considered is economic efficiency, including minimising distortions and compliance & administration costs.

Any elements of the current tax system that arbitrarily favour one mode of transportation over another will result in inefficient allocation of resources. These distortions should be identified and removed. Furthermore, the CPF is particularly concerned that some of the distorting incentives associated with the treatment of motor vehicles under current system also exacerbate un-priced third-party effects such as greenhouse gas emissions and congestion, resulting in even greater levels of economic inefficiency.

Vehicle taxes and charges

Vehicle taxes and charges should be reconsidered to ensure that these charges are fully cost reflective (including road maintenance and upgrade costs, road safety costs) and provide an incentive to reduce emissions and other related externalities. For instance, taxes or registration fees could be based on the fuel efficiency of the vehicle and redesigned to better reflect the disproportionate impact of heavy vehicles on the costs of maintaining and upgrading the road system.

The UK Government has already reformed car vehicle excise duty (VED) to relate it to carbon dioxide emissions and provide incentives for more efficient cars. They also reformed truck VED to provide incentives to use cleaner and less damaging lorries, based on an independent environmental evaluation of the impact of different trucks (HM Treasury 2002).

In June 2004, France announced the reform of their car registration tax into a 'feebate' scheme. Under this, cars that emit over 180g/km of CO₂ or diesels without a particulates filter will face a surcharge of €1,500 - €3,500, whereas cars that emit under 140g/km of CO₂ and diesels with particulate filters will receive a rebate of €200 to €700. Cars emitting between 140 and 180g/km of CO₂ will be liable to neither a surcharge nor rebate (Potter *et al* 2005).

Climate change

The CPF acknowledges the importance of the Australian Government's Carbon Pollution Reduction Scheme (CPRS) as a vital tool to reduce greenhouse gas emissions and an important example of a market based approach to address an environmental policy objective. However, it is essential that the final CPRS design provides a strong signal for greenhouse gas emission abatement in the transport sector.

Congestion charging

The merit of congestion charging in major urban areas is becoming increasingly clear and this has been outlined in the Review's Consultation Paper (2008). Road user charging, particularly at peak times should be considered in urban areas. Car parking fees can also be used as a tool to address congestion. However, the CPF believe that congestion charging need to be combined with increased investment in public transport and cycling related infrastructure in order to provide people with safe and convenient transport alternatives.

Sustainable and active transport solutions

We note and endorse the use of tax and policy initiatives adopted in other countries to promote bicycle use and other forms of sustainable and active transportation, recognising both the severity of the transport problems and the powerful incentive that taxes can have on behaviour.

In countries such as the USA, UK and Ireland where commuting to and from work is generally not tax deductible (as it is in Australia) a number of proactive approaches have been developed:

- United Kingdom—tax exemption for employers to provide bicycles and safety equipment to employees through untaxed interest-free loans (UK Government's Green Transport Plan).
- United States—US Government policy reflects the research conclusion that “direct financial incentives or subsidies are a key element of successful programs” to reduce single-occupancy car use to work. Direct incentives have been in place since the 1980's focusing on car-pooling and public transport.
- United States—\$20 a month tax relief per bicycle commuting employee (part of the recent package to address the financial crises in the USA—HR1244). To cover the cost of any employer reimbursement for reasonable expenses incurred, provided the employee “regularly uses the bicycle for a substantial portion of the travel between the employee's residence and place of employment”.
- Ireland—public transport tickets can be purchased by the employer and passed onto the employee in a tax-effective manner (Potter and Lane (2005)).
- United States, United Kingdom & Canada—*Parking cash out* initiative in the UK, US and Canada. Employees who have subsidised car parking are also offered the cash equivalent if they choose to use alternative modes of transport (Litman, 2008). This has been shown to significantly reduce car use (Terry, 2004) and could rapidly be adopted in Australia, with minimal, if any public expense.

The Australian context

In an Australian context, these schemes are equivalent to tax reforms that would allow bicycles and related accessories (helmets, lights and carry racks) to be provided by employers or purchased by employees using gross income (i.e. salary sacrificed) without incurring Fringe Benefits Tax.

To date the Australian tax system FBT provisions may have actually prevented excellent results from being realised. The CPF understands that the Public Transport Authority in Western Australia recently abandoned plans to continue a very successful program “*Cycling 100*” which provided bicycles to train drivers to encourage healthy and active living and improve workplace performance as the expenditure is currently subject to FBT, adding considerable costs to the program.

In general, CPF believe that there is good evidence to suggest that employees and employers would respond positively to such concessions for bicycles, particularly when combined with other reforms such as further promotion of cycling as a legitimate, healthy, enjoyable, and affordable transport option and investment in public cycling-related infrastructure (Beck 2007).

To ensure that such concessions are well targeted, we believe that they should be limited to certain dollar amounts per employee each year (approximately \$1,500) and subject to the condition that the bicycle is primarily used for transport to and from the workplace or for particular workplace health objectives. To reduce the compliance costs, an overall annual threshold could be introduced for FBT payable on a range of benefits that produce health benefits including bicycles.

Overall, we believe that the minor revenue impacts of encouraging active transport including cycling through the tax system would be more than offset by the resultant improvements in public health, and reductions in congestion and greenhouse gas emissions (see CPF 2008 on the Economic benefits of cycling for Australia).

Recommendations:

3. *The tax system should not distort efficient investment in, and use of, alternative forms of transportation.*
4. *A growing number of OECD countries are encouraging sustainable transport choice through the tax system and the CPF strongly recommend Australia adopt similar measures, to adapt our tax system into one that encourages efficiency, sustainability and public health.*

Conclusions

It is our recommendation that the Motor Vehicle FBT concession be modified and scaled back over time. This would significantly reduce the perverse incentive to drive excessively, potentially saving over \$2 billion (in 2009/10 forecasts) and significantly reduce each of the major problems associated with heavy car use outlined in the beginning of this submission.

The considerable savings that would result from a significant scaling back of the Motor Vehicle FBT could be transferred to fiscal policy initiatives that helped create a diversified mix of transport options—through public transport and cycling infrastructure investment. This concept is consistent with material contained in Tax Review publications, as outlined in the Tax Review's *Consultation Paper* (2008):

In some cases tax policy can contribute to the management of environmental issues by changing the incentives faced by individuals, firms and other economic factors. However, in other cases non-tax policy responses may be more effective (p. 247)

A growing number of OECD countries are encouraging sustainable transport choice through the tax system and the CPF strongly recommend Australia adopt similar measures, to adapt our tax system into one that encourages efficiency, sustainability and public health. The case for the introduction of favourable tax arrangements for sustainable transport modes is amplified should the FBT system for motor vehicles remain.

Recommendations

- CPF supports the review of the tax system including its aim of ensuring that Australia has an efficient and equitable system capable of addressing the key economic, social and environmental challenges facing Australia.
- In supporting efficient transport decisions, the CPF believes Australia would be able to more effectively meet current and future challenges by modifying and scaling back the current motor vehicle FBT system, due to its:
 - poorly targeted existing concessions that favour motor vehicles over other forms of transport; and
 - additional distorting effects of the discontinuous thresholds.
- CPF encourages the Review Panel to recommend more fundamental transport related reforms to better align the tax system with social and environmental policy objectives, including new and innovative approaches that proactively encourage cycling and other forms of active, public and low-emissions transportation.
- CPF encourages the Review Panel to ensure that their recommendations do not have perverse or unintended negative consequences in relation to climate change, congestion and public health.

Summary of recommendations:

- 1. The Motor Vehicle Fringe Benefit Tax concession should be modified and scaled back over time.*
- 2. The considerable savings that would result from scaling back or removing the Motor Vehicle FBT concessions should be transferred to fiscal policy initiatives that help create a diversified mix of transport options – through public transport and cycling infrastructure investment.*
- 3. The tax system should not distort efficient investment in, and use of, alternative forms of transportation.*
- 4. A growing number of OECD countries are encouraging sustainable transport choice through the tax system and the CPF strongly recommend Australia adopt similar measures, to adapt our tax system into one that encourages efficiency, sustainability and public health.*

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