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GM Holden Submission

to

Australia's Future Tax System Review

October 2008

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Australia's Future Tax System Review

Submission by GM Holden Ltd to the AFTS Review Secretariat
The Treasury
October 2008

Submitted via email: AFTSubmissions@treasury.gov.au

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This submission is being provided by GM Holden Ltd in response to the call for submissions following the recent release of the Treasury's Architecture of Australia's Tax and Transfer System paper. Please note that GM Holden's comments focus on the key areas of importance for our business, and more broadly, the competitiveness of manufacturing in Australia.

Executive Summary

GM Holden is Australia's largest manufacturer of vehicles and components, with operations located in Victoria and South Australia. In recent years, GM Holden's design and engineering expertise has been recognised by GM, with the responsibility for global rear wheel drive vehicle architecture development now a significant part of our business in Australia. Over the last 5 years, GM Holden has invested more than $3 billion in its Australian operations, including more than $1 billion to design and develop the VE Commodore range of vehicles for Australian and export markets. In 2007, GM Holden generated $1.56 billion in export revenue, invested $420 million in R&D to support new product and technology development and spent $0.5 billion on wages.

GM Holden welcomes the Review of Australia's Future Tax System as it is an opportunity to address specific areas of the current system which impact our ability to successfully compete in both domestic and global markets.

The long term future of the industry depends on making Australia an attractive place for global investment. The Australian market is becoming increasingly fragmented, creating significant challenges for both vehicle manufacturers and suppliers to achieve sufficient scale to cover product program investments. In a market of around 1 million vehicles, this issue becomes more significant as it is not practical in a global industry to build multiple product lines for relatively small domestic volumes. As a result, for vehicle manufacturing in Australia to be sustainable, policies must be in place to support strong domestic sales of those vehicles which are the core of the local industry.

Australian vehicle production represents only 0.5 per cent of global sales. In the long term, it is vital to be globally integrated within a multi-national corporation to ensure continuity of production and allocation of engineering development work. In this context, it is important to note that GM Holden competes with other GM entities for investment. In order to attract investment to Australia for new vehicle production, it is critical that we are able to achieve:

- Low cost production – products must be provided to the final sale market at a competitive landed cost
- For both domestic and export markets – a sufficient volume of local consumption is necessary to support the investment
- Access to capital – high labour costs in Australia have driven investment in automation and in a cash constrained industry, supportive investment schemes and access to competitively priced finance is critical
- Progressive trade policies – improving access to global markets is critical

Of these, the first three points are most relevant to the Review of Australia's Tax System. Consequently, future taxation policies must consider what is required for Australia to be an attractive place for global investment. These policies need to address the cost of manufacturing in Australia and support sales of locally made products.

While these issues are further detailed in our submission, GM Holden recommends the following changes to key taxation measures be considered which impact the competitiveness of our business on a range of levels:

Goods and Services Tax (GST)

GM Holden considers inappropriate the decision to exclude analysis of possible changes to the tax rate or tax base of a major tax such as the GST as an option to offset reduction in revenue raised from changes to the base or abolition of taxes that raise low amounts of revenue.

Exclusion of GST from the review of the Australian Future Tax System also restricts analysis of the adverse impact of double taxation on consumer behaviour. For example, consumption of fuels leads to double taxation whereby GST is assessed on the fuel excise component of the fuel price.

Recommendation:

- Include GST as part of the Review of Australia's Tax System to ensure "raising revenue (is) done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community"[1].

Fringe Benefits Tax

Fringe Benefits Tax (FBT) is not one of the top ten taxes as measured by total revenue collected. However, compliance with the tax consumes a disproportionate amount of employee and systems time compared to the amount of tax paid.

Recommendations:

- GM Holden recommends that analysis should be performed to assess what rate or base changes are required in other taxes, including GST, to allow the abolition of FBT.
- Failing this, the value of benefits could be assessed as income of individual employees at the relevant marginal rates of income tax.
- To address compliance costs, reduce the tax base to four categories - for example, cars, accommodation, loans and entertainment.

<u>Vehicles</u>

Given the significant proportion of domestically produced vehicle sales to fleet customers (75 per cent in 2007), it is vital that the importance of these sales to the sustainability of the local industry is borne in mind in any consideration of changes to the current FBT arrangements for vehicles.

[1] Item 3 of the Objectives and Scope of the Terms of Reference for the review of Australia's Future Tax System.

Recommendations:

- To manage the impact on the environment due to the perceived incentive to increase annual kilometres travelled, consideration could be given to a two tier statutory fraction system that applies a lower rate to vehicles that make use of alternative fuel technology, regardless of the distance travelled.
- Alternatively, to manage this perceived incentive to increase annual kilometres travelled, the range of kilometre thresholds and statutory fractions could be expanded.

Definition of Associates and the 'Arranger' Rules

Recommendation:

- The FBT arranger rules should be amended to ensure that fringe benefits are assessed only in circumstances where there is clear negotiation between two employers relative to the provision of a fringe benefit as a part of remuneration packages.
- Benefits supplied as a result of genuine incentive initiatives offered by a manufacturer aimed at maximising sales by employees of arm's length retailers should be excluded from the fringe benefits tax base.

Luxury Car Tax

Recommendation:

- GM Holden restates its recommendation to previous reviews that if the tax is to be continued that the threshold be lifted to, or just above, $70,000, to restore the application of the tax to its original intent.

Stamp Duty

The collection of a transactional tax in the form of stamp duty discourages consumers from turning over their vehicles periodically and hence contributes to environmental and safety issues as older vehicles remain on the roads. Apart from the flow-on community improvements in environment and safety, the industry would clearly benefit from an increasing volume of domestic sales, and any legitimate means to increase domestic sales volumes would be very beneficial to the industry.

Recommendation:

- GM Holden recommends the total removal of stamp duty payable upon a vehicle purchase.
- Failing this, consideration should be given to options such as the progressive reduction of stamp duty across an agreed schedule, as State revenue from GST increases.

Payroll Tax

GM Holden has long held the view that State payroll taxes adversely impact the competitiveness of our products in both the local and export markets, and given the increasing importance of export, this is not consistent with the aims to ensure the future sustainability of the industry.

In the context of consistency, GM Holden highlights that a key factor in developing GST free status for exported goods was the impact that the former sales tax had on the cost of exports. GM Holden strongly submits that payroll tax should be viewed in a similar way to the former sales tax. Furthermore, payroll tax is a cost that must be factored into pricing calculations for Australian based manufacturers, a cost that is not borne by competing importers. This perpetuates a competitive disadvantage.

Recommendation:

- Analysis should be performed to assess what rate or base changes are required in other taxes, including GST, to allow for the abolition of payroll tax.

Thin Capitalisation and Transfer Pricing

GM Holden considers that the rules surrounding the thin capitalisation and transfer pricing rules of Australian tax law are too complex to allow simple compliance, resulting in compliance burdens that are inefficient and unproductive.

Recommendation:

- Greater effort must be applied to simplify the law that will allow both taxpayers and the Australian Taxation Office to better understand and apply the law.
- In regard to transfer pricing, a limit on the number of years over which investigations can be performed should be set.

Taxation Measures to Encourage Energy Efficiency

Responding to climate change is a significant social and economic challenge for the future. For the automotive industry, the availability of affordable technology solutions will be the key driver for the change required and policy mechanisms are being considered in concurrent Government reviews to support this goal.

However, opportunity exists to ensure taxation policy is consistent and supportive of the aim to achieve energy diversity for the future to support overall reduction of carbon emissions and to provide energy security. These measures should focus on the production and distribution of a range of alternative fuels.

Recommendation:

- To support the Government's broader environmental policy objectives, we encourage the Government to consider taxation measures to assist in the development of infrastructure, and the upgrade of existing facilities, to support wider availability of alternative fuels.
- In particular, GM Holden recommends that consideration be given to extending taxation concessions to companies involved in the production and distribution of alternative fuels, including LPG and biofuels such as ethanol. In the case of ethanol, focus could be given to incentives to encourage the introduction of sustainable, second-generation production technologies or for the production of ethanol from non-food sources.

R&D Tax Concession

In GM Holden's view, there are some major adjustments required to the current innovation and R&D incentive mechanisms which are available to the automotive industry to encourage further innovation. In particular, the R&D tax concession needs urgent review. While our views have been discussed in more detail in our submissions to both the Review of the National Innovation System and Australian Automotive Industry, the key recommendations from these submissions are as follows:

Recommendations:

- GM Holden recommends that the benefit of the R & D tax concession/rebate should be at least 15 per cent.
- GM Holden recommends that the Review of Australia's Future Tax System consider the recommendations in the Cutler Innovation Report to modify the R&D tax concession criteria so that IP ownership, overseas funding/support and technical assistance are not impediments to eligibility.
- We agree that the R&D tax concession should be replaced with an R&D rebate system so that all companies (not just those eligible for the R&D tax off-set) may obtain a cash benefit.
- The tax concession/rebate should not be restricted to solely income tax attribution, but rather it could be used to offset other taxes such as payroll tax to recognise circumstances where the immediate financial benefit of any concession cannot be utilised as a result of accumulated income tax losses.

1. Introduction

GM Holden is a wholly owned subsidiary of General Motors Corporation (GM), and occupies a special place in Australian automotive history. GM Holden is a trusted Australian brand, and iconic automobiles such as the Commodore and Holden Ute are part of the Australian culture.

In Australia, GM Holden markets a range of vehicles under the Holden brand including the locally manufactured VE Commodore and WM Statesman and Caprice, and vehicles imported from GM affiliates world-wide including the Captiva, Barina, Viva, Astra and Colorado. In addition, GM Holden markets the GM brands Saab and Hummer, and will introduce Cadillac into the Australian market next year.

As Australia's largest vehicle manufacturer, with major facilities located in South Australia and Victoria, GM Holden's operations include a vehicle assembly plant in Elizabeth, South Australia. Established in the period from 1958 to 1966, this year marks the facility's 50th anniversary. Holden's Vehicle Operations (HVO) is noted as one of the world's most versatile vehicle assembly facilities, producing a number of body styles in both right and left-hand drive configurations. The annual capacity of the plant is 145,000 vehicles over two shifts and on that basis the plant can produce at its full capacity 620 vehicles per day.

GM Holden's manufacturing facilities also include Holden Engine Operations (HEO) in Victoria. HEO currently manufactures the Family II 4 cylinder and Global V6/HFV6 engines, along with iron castings and brake and suspension parts. HEO is Australia's largest exporter of automotive components, producing 269,421 engines in 2007 (132, 721 HFV6 engines and 136,700 Family II engines), of which 184,795 were exported to China, Europe, Korea, Thailand and South Africa. Other facilities based in Victoria include the Holden Service Parts Operations (HSPO) in Dandenong, and the Holden Proving Ground based at Lang Lang, which has been the testing ground for every Holden developed in Australia.

Over the last 5 years, GM Holden has invested more than $3 billion in its Australian operations. This has included major investments in the new HFV6 engine plant, upgrades to the vehicle assembly plant to support the introduction of new models such as the VE Commodore and derivative vehicles, and in product development.

GM Holden's Australian headquarters is located at Port Melbourne and importantly incorporates significant design and engineering activity. The launch of the new VE Commodore range in 2006 represented GM Holden's largest ever R&D program and Australia's first billion dollar car. Since its launch, the VE has continued Commodore's twelve year leadership as Australia's best selling car, earning a number of awards including the prestigious title of Wheels Car of the Year 2006. In recent year's, GM Holden's design and engineering expertise has been recognised by GM, with the responsibility for global rear wheel drive vehicle design and architecture development now a significant part of our business in Australia.

GM Holden has successfully evolved from a local car manufacturer to become a truly global business with exports a key part of future business strategy. In 2007, GM Holden announced new vehicle export programs to the US and Korea, and two versions of the Global V6 engine to China to power the new Buick Park Avenue. The Pontiac G8 Sedan also commenced production in November 2007 for export to the US, adding to existing programs for markets including the Middle East, New Zealand, Brazil and South Africa – recognising GM Holden's capability to produce high quality, internationally competitive vehicles. In 2008, we have announced the Pontiac G8 GXP sedan and sport truck (Holden Ute) export programs to the United States, and for the first time in Holden's history, over 50 percent of our locally manufactured vehicles will be for export markets.

2. GM Holden's Business Model

GM Holden is committed to maintaining its business operation in Australia, and has recently completed work to develop its strategic business plan for the coming years.

GM Holden's vision is to be:

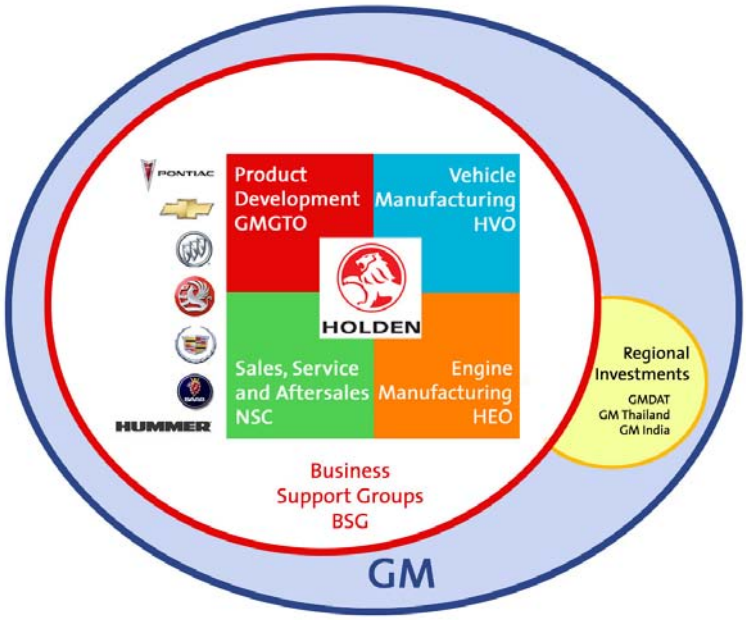
"Australia's own, competing and winning on the world stage".

This vision is supported by the following mission statement:

"To enthuse our customers with the best automotive products and services by combining the expertise and passion of our people with GM's global capability to deliver business objectives and community benefit".

In Figure 1, the breadth and depth of GM Holden's role within GM is illustrated. Our business model includes the sale of local and imported vehicles, the manufacture of both vehicles and engines for domestic and export markets, and product development for Holden as well as GM global brands including Pontiac, Chevrolet, Buick and Vauxhall.

Figure 1 – GM Holden's Business Model



Translating the strategic direction and the various elements of the Strategic Business Plan into our company's direction for the future it is clear that understanding and interpreting domestic and export markets in a way that maximises GM Holden's strategic opportunity will be critical. In this regard, GM Holden has staked a claim to the global market opportunities for large rear wheel drive passenger motor vehicles, and will use this position to maximise sales of the Commodore and Statesman range of vehicles and their variants.

In the context of a gradually shrinking Australian market for larger conventional sedans, the vehicle platform must spin off a number of additional "variants" in future years. To achieve this outcome the platform must be designed to be highly flexible and able to utilise various common elements of the vehicle structure through a modular approach.

With a relatively small production volume and correspondingly small capital resources, GM Holden is arguably one of the few viable manufacturers of its size in the world, but this may not continue to be the case in future if we are unable to attract continued investment and maintain viable domestic and export production volumes.

In addition, for GM Holden to succeed cash flow must be sufficient to drive continued investment in future products and technologies, and to sustain manufacturing and engineering operations. This is critical in terms of ensuring the long term viability and value of the Australian operations to GM's global activity.

As a result, taxation policy arrangements are of critical importance to GM Holden as they impact our business performance on a range of levels.

3. Attracting Global Investment

The Australian vehicle market, similar to other markets around the globe, is becoming increasingly fragmented. This fragmentation creates challenges for manufacturers, who had previously operated on a 'build where you sell' philosophy, to now obtain sufficient scale to cover product program investments. This dilemma has resulted in vehicle plants specialising in products which have strong domestic demand, and then leveraging any excess capacity to supply export markets. The Australian vehicle manufacturers are able to leverage this capacity to complement their portfolio of domestically produced vehicles with products imported from within their parent's global manufacturing structure to ensure they can meet the changing customer requirements.

In the Australian vehicle manufacturing context where the overall market is only about 1 million units, the issue of scale becomes even more critical as it is impractical and uneconomic to build multiple product lines for small domestic volumes. **The long term future of the industry depends on making Australia an attractive place for global investment**. While our views on this matter have been discussed in more detail in our submission to the Review of Australia's Automotive Industry, it is worth noting some key points.

In sustaining the industry in Australia, it is vital that manufacturers have strong demand for locally produced vehicles, across all customer segments - governments, fleets, private buyers - and are not overly reliant on export volumes, as Global OEMs have alternatives to produce vehicles in locations that may be more attractive due to cost, proximity to the export market, or more favourable government policy.

Competition for global vehicle production investment is intense and GM Holden must compete with other GM plants around the world. The scale of this challenge is graphically illustrated in Figure 2.

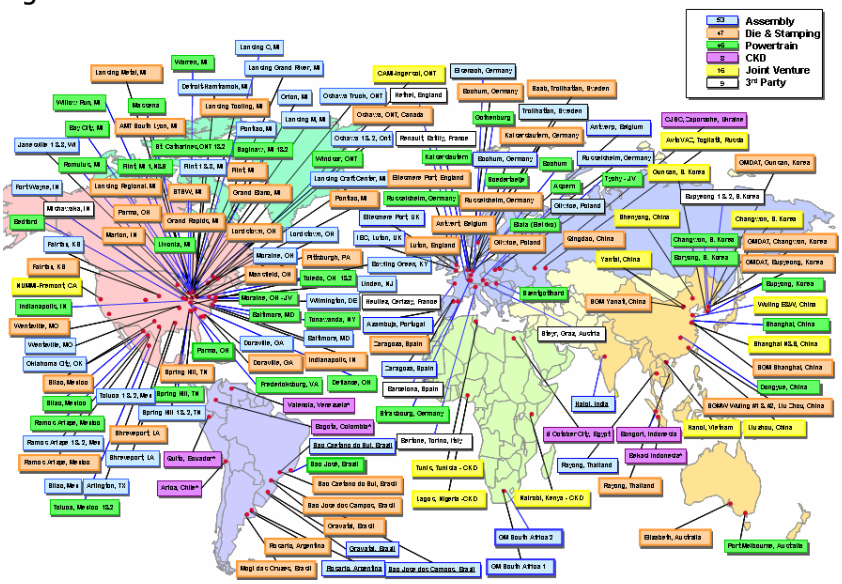


Figure 2: GM Global Plant Map

Global investment decisions, like market allocations, are rational. Emerging markets have strong and often heavily subsidised investment programs to attract global investment. The ongoing challenge is to make Australia the most attractive destination for these global platforms.

In any industry, competitive advantage can be gained through cost advantage or through differentiation. Arguably for automotive they are one and the same in terms of investment decision. Skills and technology are now portable and logistical supply lines more responsive and organised, thus making replication a reality in automotive manufacture as evidenced by emerging market success.

As a result a combination of the following requirements would need to be met in order to encourage investment in new vehicle production in Australia:

- Lowest cost production - Cost is a critical factor in future investment decisions. GM Holden must be able to provide a product at the lowest landed cost (inclusive of duties, excise and other regulatory burdens) in final sale market.
- Markets, both local and export - There are few global examples of a vehicle that is produced in a country only for export, without any consumption in the production country. In most cases, there is a volume of local consumption that supports the investment.
- Access to capital - For Australia, the high cost of labour means there is a high level of capital investment in automation required, which is an immediate and draining cost in a largely cash constrained industry. An environment of available, competitively priced investment funds is a vital element. Australia has policy that supports this on a small scale in the form of the Export Finance and Investment Corporation (EFIC), where minor funding is provided to support fledgling export programs. These principles may be scaleable to support the future development of the industry.
- Progressive trade policies - This is an area where Australia has been a global leader, providing access to its market, in some cases without the same level of transparent reciprocal access to other markets.

Of these, the first three points are of relevance to the consideration of Australia's future tax system. Our ability to deliver low cost production is impacted by a range of taxation measures and equally, sales in the domestic market are also impacted by taxes both on the business and the vehicle itself. Consequently, future taxation policies must consider what is required for Australia to be an attractive place for global investment. These policies need to address the cost of manufacturing in Australia and support sales of locally made products.

4. Taxation Policy Arrangements Impacting the Automotive and Other Manufacturing Industries

A competitive policy environment for the Australian automotive industry is vital to ensure ongoing sustainability. Due to the relatively small scale of the Australian automotive industry in global terms, the strategy for future success involves becoming a competitive, quality supplier of products for both the domestic and global markets. To do this we need policies that encourage continued investment and a greater focus on innovation in both products and processes, especially over the longer term – taxation policy can have a significant impact on this outcome.

Regardless of the form and extent of Government support for the industry, it must take into account the need for the Government policy environment itself to be internationally competitive. It is well accepted that developed and developing countries worldwide value ongoing investment in their automotive industries. If Australia is to be viewed by international investors as a competitive location, it must be seen as a country that supports its car industry.

For example, GM globally analyses cost in terms of the after tax cost. This is particularly relevant to its engineering cost which includes R & D activity. Within the Asia-Pacific region, GM is able to use a range of R & D incentives via increase or accelerated income tax deductions or specific taxation exemptions. Whilst Australia has similar concessions, GM Holden considers that they should be enhanced so that the after-tax benefit is increased to ensure that Australia is a viable alternative to other countries in the Asia Pacific region in making investment/business decisions.

GM Holden welcomes the Review of Australia's Future Tax System as it is an opportunity to address specific areas of the current system which impact our ability to successfully compete in both domestic and global markets.

In addition, the review of taxation policy should address the impact of the very high incidence of state and federal taxes that are imposed on passenger motor vehicles. Taxes imposed include direct taxes such as GST, luxury car tax, registration fees and stamp duties on the purchase and transfer of vehicles. Indirect taxes on the operation of motor vehicles such as Fringe Benefits Tax (FBT), fuel excise and stamp duty on insurance also increase the tax impost related to owning a motor vehicle.

The following taxation policy areas are of particular interest to GM Holden's business in Australia, and as such we have outlined our comments on the future opportunities below.

4.1 Consideration of GST

In this review of Australia's Future Tax System, it is noted that GST is excluded from consideration of the appropriate balance between taxation of the returns from work, investment and savings, consumption and the role played by environment taxes. GM Holden is concerned by this restriction.

The Australian Treasury Report entitled "Architecture of Australia's tax and transfer system" records that Australians pay at least 125 different taxes each year and 90 per cent of the total tax revenue collected by Australian governments in 2006-7 was derived from just 10 taxes. These 10 taxes accounted for 95 per cent of Australian government tax revenue and 70 per cent of State tax revenue (including 100 per cent of local government tax revenue). In 2006-7, 10 per cent of tax revenue was contributed by the remaining 115 taxes[2].

Further analysis of the Architecture Report identifies that GST accounts for 13 per cent of Australian government tax revenue and is the third largest source of tax revenue after individual and other withholding taxes and company tax. Payroll tax accounts for 29.44 per cent of State tax revenue and 4.5 per cent of total Australian government tax revenue.

GM Holden considers inappropriate the decision to exclude analysis of possible changes to the tax rate or tax base of a major tax such as the GST as an option to offset reduction in revenue raised from changes to the base or abolition of taxes that raise low amounts of revenue. The decision to exclude GST from analysis seems to limit development of options to ensure "....(R)aising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community"[3].

4.1.1 Double Taxation

Exclusion of GST from the review of the Australian Future Tax System also restricts analysis of the adverse impact of double taxation on consumer behaviour. For example, consumption of fuels leads to double taxation whereby GST is assessed on the fuel excise component of the fuel price.

Consideration must be given to elimination of this anomaly.

An efficient taxation system must preclude and eliminate all circumstances where double taxation can and does exist.

4.2 Fringe Benefits Tax

GM Holden has noted that the fringe benefits tax (FBT) is not one of the top ten taxes as measured by total revenue collected. However, compliance with the tax consumes a disproportionate amount of employee and systems time compared to the amount of tax paid. The major areas of unproductive effort include:

[2] Section 2.3 and Chart 2.2, Architecture of Australia's tax and transfer system Report, Australian Treasury, 6 August 2008

[3] Item 3 of the Objectives and Scope of the Terms of Reference for the review of Australia's Future Tax System.

- Collection and analysis of employee declarations to affirm such things as kilometres travelled and employee contributions for car benefits or living away from home status; and
- Collection and transfer of information related to benefits that must be assessed by other unrelated employers under the so-called 'arranger rules'.

Accordingly, GM Holden recommends that analysis should be performed to assess what rate or base changes are required in other taxes, including GST, to allow the abolition of FBT. Failing this, the value of benefits could be assessed as income of individual employees at the relevant marginal rates of income tax.

A further area of opportunity to reduce the compliance burden of this tax would be to reduce the tax base to four categories – for example, cars, accommodation, loans and entertainment. This would allow compliance costs to be reduced by reducing the level of effort required to monitor the myriad of other low value transactions currently within the FBT net.

Other alternatives to the total abolition of this tax that could be considered are discussed below.

4.2.1 FBT on Vehicles

The operation of the FBT for vehicles is an important consideration for sales of vehicles into Australian business fleets and for novated lease arrangements. Indeed, fleet sales are critical to the local industry comprising around 75 per cent of all sales of domestically produced vehicles in 2007.

Figure 3 shows the proportion of domestically produced vehicles which are sold to fleet customers – for the industry as a whole, and for GM Holden.

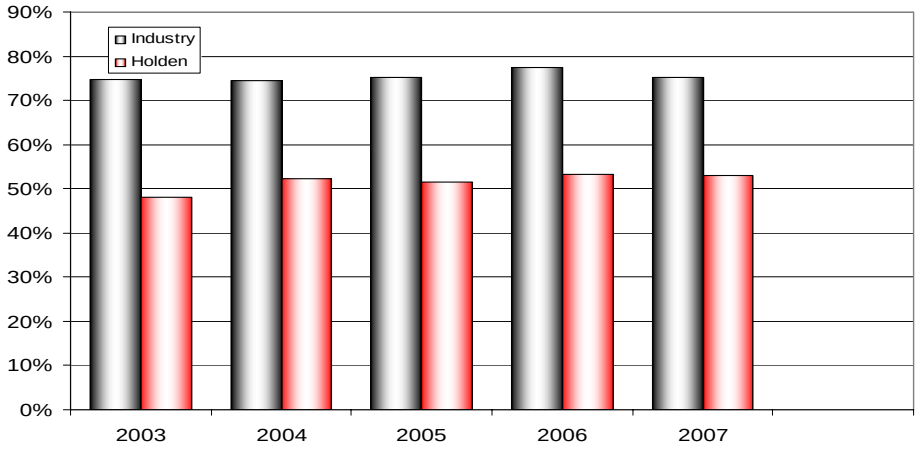


Figure 3: The Importance of Fleet Sales for Australian Automotive Manufacturers

The statutory formula method for calculating FBT is based on the number of kilometres traveled and the statutory fractions are higher for lower kilometres (0.26 for under 15,000kms p.a.) and lower for higher kilometres (0.07 for over 40,000kms). This method of assessing the taxable value of car benefits has been claimed to encourage unnecessary vehicle use. GM Holden's own experience, together with broader anecdotal evidence, suggests employees may drive extra distances to avail themselves of lower thresholds under the statutory formula method of assessing car fringe benefits. Not only is this inefficient, it clearly runs counter to national efforts to reduce carbon emissions.

Accordingly, GM Holden recommends the following changes to FBT arrangements for vehicles be considered:

- To manage the impact on the environment due to the perceived incentive to increase annual kilometres travelled, consideration could be given to a two tier statutory fraction system that applies a lower rate of FBT for vehicles that make use of alternative fuel technology, regardless of the distance travelled.
- Alternatively, to manage the perceived incentive to increase annual kilometres travelled, the range of kilometre thresholds and statutory fractions could be expanded.

4.2.2 Definition of Associates and the 'Arranger' Rules

The definitions surrounding, and relationship between, associates and third party arrangements are too broad and need to be refined. The broad application of the rules means that some arm's length incentive arrangements that are funded by GM Holden and provided to employees of dealers are included for FBT purposes. The benefits caught do not form part of the remuneration package of the associate's employees and are funded as part of the business operations of the 'sponsor' of the incentive.

GM Holden recommends that the FBT arranger rules be amended to ensure that fringe benefits are assessed only in circumstances where there is clear negotiation between two employers relative to the provision of a fringe benefit as a part of remuneration packages. Benefits supplied as a result of genuine incentive initiatives offered by a manufacturer aimed at maximising sales by employees of arm's length retailers should be excluded from the fringe benefits tax base.

4.3 Luxury Car Tax

The recent increase in the LCT from 22 to 33 per cent for vehicles above $57,180 will increase costs for our customers. GM Holden has previously made known its position regarding the Federal Government's modification of the conditions of the Luxury Car Tax. This position was outlined in GM Holden's submission to the current Review of Australia's Automotive Industry 2008 and its submission to the recent Senate Committee inquiry into the proposed amendments.

In these submissions, GM Holden noted the Government's decision and that the basis for the introduction of a LCT was to protect the market pricing of locally produced vehicles. GM Holden recognises the Government's rationale for recommending changes and agrees that the LCT should continue to be based purely on a price threshold. However,

changes to the product features of vehicles, including regulatory, emissions, performance and safety enhancements, in addition to customer requirements, have resulted in a "luxury" vehicle being priced well above the current threshold and well below the contemporary notion of what a luxury vehicle might constitute in the Australian vehicle market. Reflecting this, the VFACTS national reports for vehicle sales class a luxury vehicle as those priced above $70,000.

Following the passage of the Bill through the Senate in late September, a number of modifications were made to the amended legislation, including the exemption from the tax for cars valued up to $75,000 which use no more than 7 litres of fuel per 100 kilometres. The exemption from the LCT for primary producers and tourist operators was also passed.

Whilst we welcome some of our vehicles being exempted from any increase (e.g. Saab 9-3), we look at the increase in LCT in terms of the overall impact it will have across our business and not just specific models. On that basis, it remains our view that raising the threshold would have been the best way to ensure the tax was achieving what it says it is aiming to do and that is to be a tax on 'luxury cars'.

Consequently, GM Holden restates its earlier recommendation that if the tax is to be continued that the threshold be lifted to, or just above, $70,000, to restore the application of the tax to its original intent.

4.4 State and Territory Taxes

In general, competitive taxation arrangements are needed to enable the industry to succeed with minimal levels of government support. For State and Territory taxes, many reforms will be required over time, but the most urgent are the removal of payroll tax for manufacturing industry, and the elimination of stamp duty on motor vehicle sales.
In addition, reforms are required to address the impact of State and Territory taxes on companies that operate nationally. For example, at the most simplistic level, variations in the rates of a range of stamp duties mean that manufacturers are unable to simply produce one national price list. This creates complexity and confusion for consumers as well as adding to the cost of operating a business where a range of price lists must be produced solely to comply with the State and Territory tax variations.

4.4.1 Stamp Duty

State revenues are collected through a variety of means including payroll tax, workers' compensation levies, land tax and stamp duties. Of these, the elimination of stamp duty as it applies to vehicle sales would have the largest impact on the automotive industry.

The collection of a transactional tax in the form of stamp duty discourages consumers from turning over their vehicles periodically and hence contributes to environmental and safety issues as older vehicles remain on the roads. Apart from the flow-on community improvements in environment and safety, the industry would clearly benefit from an increasing volume of domestic sales, and any legitimate means to increase domestic sales volumes would be very beneficial to the industry and broader economy.

The full benefits would only be obtained by the total removal of stamp duty payable upon a vehicle purchase. Failing this outcome, other options include progressively reducing the stamp duty across an agreed schedule, as State revenue from GST increases. However, any options that provide stamp duty concessions based on vehicle type or performance must be carefully developed so as not to lead to distortions in the market that may be inconsistent with industry policy direction. In this regard, the introduction by certain States of stamp duty rates based on engine size has a negative impact on sales of locally manufactured vehicles which predominantly have 6 or 8 cylinder engines.

4.4.2 Payroll Tax

In regard to payroll tax, GM Holden has long held the view that State payroll taxes adversely impact the competitiveness of our products in both the local and export markets, and given the increasing importance of export, this is not consistent with the aims to ensure the future sustainability of the industry.

In the context of consistency, GM Holden highlights that a key factor in developing GST free status for exported goods was the impact that the former sales tax had on the cost of exports. GM Holden strongly submits that payroll tax should be viewed in a similar way to the former sales tax. Furthermore, payroll tax is a cost that must be factored into pricing calculations for Australian based manufacturers, a cost that is not borne by competing importers. This perpetuates a competitive disadvantage.

From an administrative perspective, GM Holden fully supports the current work by State Governments to harmonise the payroll tax legislation. However, harmonisation will not of itself reduce inherent complexity of payroll tax law and its associated compliance obligations, nor will it eliminate the adverse impact of the competitiveness of GM Holden products in both export and local markets.

For example, in an era of significant workforce mobility and use of contract labour to address ebbs and flows of effort required in a manufacturing business, the obligation to review each and every short term contract to assess whether or not a contractor should be assessed as an employee for payroll tax purposes is not efficient. An alternative approach to reduce reviews is to develop generic rules for use by business units responsible for appointment of contractors. However, this is also fraught with the risk that those business units may not identify subtle differences in contract arrangements, leading to inadvertent errors in the assessment of payroll tax.

A similar record retention compliance effort is also required for entities that operate in more than one state and require their employees to be mobile within Australia. The payroll tax law of each state and territory requires employers to constantly monitor employee mobility to ensure accurate determination of the state or territory in which an employee's salary should be assessed to payroll tax.

Complexity is also exemplified by having a component of assessable wages linked to a separate tax base (fringe benefits tax) that has a different definition of "employee" and is assessed on a different time cycle. Leaving aside the effort required to complete

annual returns and reconciliations, the need to refer to different tax bases leaves open the potential for errors in assessment of payroll tax.

GM Holden recommends that analysis should be performed to assess what rate or base changes are required in other taxes, including GST, to allow for the abolition of payroll tax.

4.4.3 Vehicle Registration Fees

GM Holden is concerned by proposed arrangements in various States that would set vehicle registration fees based on a range of measures such as vehicle size, engine capacity, age or emissions levels.

GM Holden considers that, when an Emissions Trading Scheme is in place, the imposition of any additional measures on particular industries or sectors should occur on the basis of identified market failures.

It is GM Holden's view that these types of policies be discouraged as they may have unintended consequences and create market distortions. In addition, as policy design to achieve a particular outcome becomes more prescriptive, it is less likely that companies will be able to find innovative, cost effective solutions to the challenges that need to be addressed.

4.5 Dividend Imputation

As noted earlier, GM Holden is a wholly owned subsidiary of a non-resident shareholder. As a result, we concur with the commentary in the Architecture paper[4] that dividend imputation is "less relevant to the financing and investment decisions of GM Holden".

In fact, due to GM Holden's parent being a resident of the United States, dividend imputation imposes a compliance burden that is of no financial benefit to GM Holden or its shareholder.

As a result of changes to the Australia United States double tax treaty, the issue of payment of fully franked dividends by GM Holden to its US resident parent becomes moot. The double tax treaty now allows for payment of a dividend by GM Holden to its US resident parent to be free of any withholding tax.

Accordingly, the only impact the dividend imputation system has on GM Holden is to impose an obligation to maintain a franking account which records franking credits that are unlikely to be utilised.

[4] Section 8.3 The Treatment of Different Holding Entities, Architecture of Australia's tax and transfer system Report, Australian Treasury, 6 August 2008

4.6 Thin Capitalisation and Transfer Pricing

GM Holden considers that the rules surrounding the thin capitalisation and transfer pricing rules of Australian tax law are too complex to allow simple compliance.

In terms of the thin capitalisation rules, the reliance on Australian International Financial Reporting standards to provide definitions of debt, as opposed to income tax law, leads to decisions that are made on the basis of subjective analysis. Uncertainty continues to exist amongst accounting standard regulators as to what constitutes debt/interest, leaving final taxation assessment in the hands of tax regulators who are not supported with concise clear taxation law. This imposes compliance burdens that are inefficient and entirely unproductive.

In terms of transfer pricing rules, the recent Administrative Appeals Tribunal case involving Roche Products Pty Limited [5] demonstrates the difficulty encountered when completing a comparative study that supports a taxpayer's assessment of what constitutes the appropriate profit margins within a specific industry and how the Australian Taxation Office can determine an alternative profit margin without appeal.

Greater effort must be applied to simplify the law that will allow both taxpayers and the Australian Taxation Office to better understand and apply the law.

Further, and in the context of transfer pricing, the Commissioner of Taxation is not constrained to any limit on the number of years over which he may perform an investigation. This imposes an intolerable burden on taxpayers to retain a corporate memory of calculations and process - let alone record retention obligations that go far beyond what may otherwise be required under common law.

4.7 Taxation of Financial Arrangements

Proposals for the taxation of financial arrangements have been under discussion for nearly 17 years. The failure to bring into operation tax law for the taxation of financial arrangements is of significant concern and GM Holden urges the Government to act to provide these arrangements as soon as possible.

[5] Roche Products Pty Limited and Commissioner of Taxation (2008) AATA 639 (22July 2008)

5. Taxation Measures to Encourage Energy Diversity

Responding to climate change is a significant social and economic challenge for the future. For the automotive industry, the availability of affordable technology solutions will be the key driver for the change required.

Last year, the global industry sales were just under 71 million vehicles, and GM is forecasting volume will grow to 98 million annual sales in ten years. There are already close to 900 million vehicles in the world today, but only about 13.5 per cent of the world's 6.6 billion people enjoy the benefits of automobile ownership. It is GM's expectation that 15 per cent of the world's population will own a vehicle by 2020, and there could be more than one billion vehicles in the global car parc.

Across the globe, new regulatory standards are requiring significant increases in fuel economy, and large-scale reductions in greenhouse gas emissions. In Europe, the industry is facing an almost 20 per cent reduction in CO_2 emissions by 2012. In the U.S., CAFE standards are expected to increase by 40 per cent by 2020 and further fuel economy regulation is also coming to China, Korea, Japan, and other countries. In Australia, the Carbon Pollution Reduction Scheme is planned to be introduced in 2010, and this will have a significant impact on the economy as a whole, and with the inclusion of the Transport sector, on consumers' future vehicle choices. Perhaps most importantly, customer demand for "greener" products is growing in every region, driven by concern for the environment and the simple economics of fuel prices.

Today, more than a third of the world's energy needs are met with petroleum. As demand rises around the globe, there is growing unease about petroleum supply and pricing. There are also increasing calls for more sustainable energy pathways amid concerns around the environment and global climate change. Given these issues – which collectively have come to be called energy security – the automotive industry, as a business necessity, must reduce the automobile's heavy dependence on oil in order to continue to meet the growing demand for our products.

5.1 Alternative Fuels - Production and Infrastructure

While policy mechanisms to encourage investment and support for the development of the required technologies is being considered as part of several Government reviews, there are also opportunities to ensure consistency of policy intent, and to support the introduction of alternative fuels and supporting infrastructure through appropriate taxation measures.

General Motors believes that the key to future success will be in finding multiple ways to displace the use of petroleum in our vehicles. To accomplish this, GM is pursuing energy diversity on several fronts. These include:

- the continued improvement of the efficiency of internal combustion engines, both petrol and diesel;

- intensifying efforts to displace traditional petroleum-based fuels with biofuels including ethanol and other alternative fuels;
- associated with this, the development of sustainable production processes, such as cellulosic ethanol production which uses carbon-based waste material as feedstock; and
- the development of electrically driven vehicles, such as hybrids, fuel-cells and extended-range electric vehicles.

This broad approach is based on a belief that there are multiple solutions to a future less dependent on petrol and that given the varied uses for vehicles and driving environments, many technologies may come to co-exist in the marketplace.

LPG/CNG

GM Holden currently offers a "factory-fitted" LPG option. Holden's *Sequential Vapour Gas Injection* system is available in a dual-fuel option on some variants of our vehicles, and produces power and torque figures close to that of petrol for the same engine.

GM Holden is currently working to develop a mono-fuel LPG system for introduction in the near future. A mono-fuel LPG system reduces CO_2 emissions even further than a dual-fuel system as it does not require petrol and also because the engine is optimised for LPG usage.

The comparatively low cost of LPG stimulates greater market demand during periods of high petrol prices, and this is a significant factor in the purchase decision. However, there are aspects of using LPG which create some drawbacks for consumers. The availability of the fuel in some regional locations can be an issue and is often cited as a reason by fleet and retail customers not to purchase these vehicles.

When it comes to other hydrocarbons, we may see an expanded role for natural gas used either as an engine fuel directly or perhaps as a feedstock for other gas to liquid fuel alternatives. Natural gas as an automotive fuel has its challenges, but Holden is closely following developments in this area.

Ethanol

Already, Australia has a burgeoning bio-fuel industry which includes production of both bio-diesel and ethanol. These fuels are currently used as blending agents, in effect extending the use of the fuels to which they are added.

The benefits of ethanol include the fact that it is a comparatively clean-burning, renewable fuel, and there are relatively small costs involved to modify current technology for use with this fuel.

Of promise is the potential to produce ethanol from biomass, which greatly improves the environmental credentials of this fuel, and research and commercialisation in this area is

gaining momentum. Cellulosic ethanol has all of the benefits of ethanol and the added benefit that it comes from diverse and plentiful feedstocks.

GM has partnered with an organisation (Coskata) in the US to develop a commercial cellulosic ethanol production facility. The process is expected to produce ethanol for less than US $1.00 a gallon, or approximately half the production cost of US gasoline. Significantly, Coskata's cellulosic ethanol process generates up to 7.7 times as much energy as what is used to make the fuel compared to conventional gasoline (data source: Argonne National Laboratory). Most recently, on 1 May 2008 GM announced a strategic relationship with Mascoma Corp. to develop cellulosic ethanol focused on Mascoma's single-step biochemical conversion of non-grain biomass into low-carbon alternative fuels to help address increasing energy demand.

GM's global reach and breadth of experience with ethanol ensures that GM Holden is well positioned in regard to this fuel, with opportunities to introduce E85 compatible technology in its locally manufactured vehicles being considered. In addition, GM Holden is also interested in local opportunities to advance cellulosic ethanol research.

To support the Government's broader environmental policy objectives, we encourage the Government to consider taxation measures to assist in the development of infrastructure, and the upgrade of existing facilities, to support wider availability of alternative fuels.

In particular, GM Holden recommends that consideration be given to extending taxation concessions to companies involved in the production and distribution of alternative fuels, including LPG and biofuels such as ethanol. In the case of ethanol, focus could be given to incentives to encourage the introduction of sustainable, second-generation production technologies or for the production of ethanol from non-food sources.

6. Taxation Issues Considered in Current Government Reviews

6.1 Carbon Pollution Reduction Scheme

While GM Holden has provided a separate submission to the Carbon Pollution Reduction Scheme Green Paper, it is worth noting specific reference to tax and accounting issues in the proposed scheme.

The Government has signaled its intention to develop discrete provisions of the income tax law which would generally provide the same tax treatment to permits purchased by taxpayers who are carrying on a business or other income-earning activity as would occur under existing legislation. The provisions would allow a deduction for expenditure incurred on the purchase of a permit and include any proceeds from the sale of a permit in assessable income.

GM Holden supports this approach and the intent to provide increased certainty and reduced complexity. It should be clear that the Goods and Service Tax (GST) is not attributable to the value of free permits or the value of a cash grant. GST rules should be considered and clarified for barter and contra arrangements, as well as set off arrangements.

6.2 Review of Australia's National Innovation System

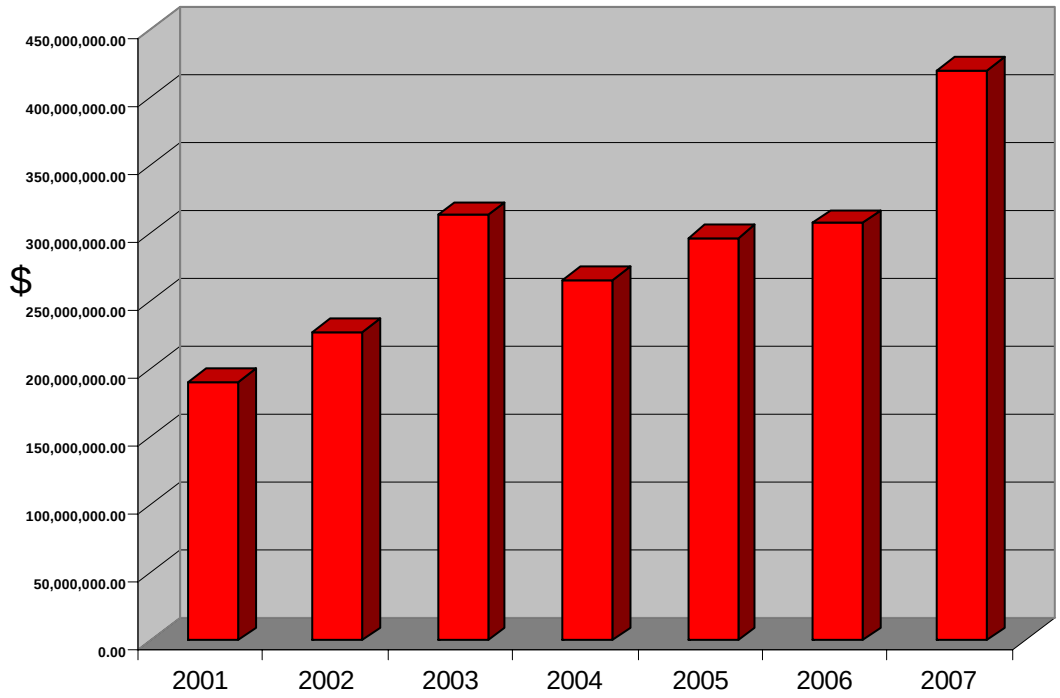
The automotive industry is a vibrant industry adopting new technology and entering R&D programs with the vigour usually associated with IT and telecommunications companies. One of the major trends in the global automotive market is the demand for vehicles incorporating higher levels of technology, which in turn is driving an increase in the level of spending on R&D.

The industry's increasing uptake of new technology is helping Australia to create advanced vehicles with global appeal and build presence in markets such as the United States and Middle East. Advanced technology has been a major contributor to this trade success and we have seen increasing sales of vehicles built in Australia which have included technology developments in materials and systems to ensure that the vehicles can meet specific technical requirements in those markets.

The automotive industry in Australia is one of the largest contributors to business R&D and wider innovation capability in this country. The industry is responsible for around $700 million in R&D each year, and GM Holden invested $420 million in 2007 alone as illustrated in Figure 4.

In the key area of support for R&D, Australia is lagging behind other developed countries. GM Holden has discussed the need to enhance the level of investment support for innovation and R&D in its submissions to both the Review of the National Innovation System and the Automotive Industry Review.

Figure 4: GM Holden R&D Spend 2001 – 2007



Adequate reward for high levels of innovation and technical risk is a necessary feature of any future Australian innovation program. At the same time, in order to protect the revenue it is desirable that access to highly assisted support measures be restricted to projects that are fully developed and are strongly backed by organisations capable of putting them into volume production. Only through innovation in both products and processes can the Australian automotive industry hope to claw back domestic market share and find crucial new export niches to develop.

GM Holden believes that there are opportunities for improvements to be made in current policy to assist not only the automotive industry, but other industries more broadly to benefit from improved mechanisms for the support of innovation.

6.2.1 The Effectiveness of the R&D Tax Concession

The R&D tax concession is available to all Australian companies and has supported the development of numerous new model and manufacturing process improvements in the automotive industry since 1988/89. In the past, the tax concession has been a major benefit used by GM Holden to offset its considerable investment in R&D.

The tax concession scheme provides three forms of concession:

- a tax deduction on relevant expenditure of 125 per cent;
- a tax deduction of 175 per cent on incremental expenditure above a 3 year moving average; and
- a new 175 per cent International Premium Concession on incremental expenditure in accordance with separate provisions.

The base concession (the 125 per cent deduction) only provides a subsidy of 25 per cent times the corporate tax rate of 30 per cent, or a net benefit of 7.5 per cent of the eligible expenditure. Such a low rate of assistance would obviously be more relevant to projects of low risk than of high risk. If for example a project only had a 5 per cent risk of failure the subsidy would exceed the ”expected value” of the cost of failure – that is, 5 per cent. If on the other hand a project had only a 50 per cent probability of success the assistance level of 7.5 per cent compares very poorly with the “expected value“ of loss, which would be 50 per cent of project costs. In addition, for companies operating in Australia as a subsidiary of a global parent, there is also the issue of ownership of IP and overseas funding of R&D where technical risk and financial risk are evident.

With regard to the two categories of the 175 per cent rate of deductibility, we note that this higher rate only applies to incremental expense above a base level. As a result, for an industry like automotive manufacturing, which has a very high, steady rate of R&D expenditure, this concession is of little relevance. On the other hand the 175 per cent rate might be of major influence on project decisions in an industry with a low base level of R&D spending, interrupted by intermittent high “spikes” of expenditure. Unfortunately, the automotive industry is not in this situation. Again, there are issues associated with the ownership of IP and clawback provisions.

Since 1 January 2005, GM Holden has been unable to maintain an R&D claim at the 125 per cent rate due to the fact that we are part of a global engineering framework and our IP is now owned and managed globally. As part of a multi national motor vehicle manufacturer, the GM Holden R&D expenditure budget is controlled centrally in order to maximise its effectiveness. Unfortunately, as we are reimbursed for this work GM Holden fails to meet the financial risk criteria for eligibility.

From our previous experience with the scheme, the compliance effort required to support tax concession claims was very exacting and required significant engineering resources. In addition, the absence of a statute of limitations requires "evidence of compliance" material to be maintained into perpetuity with unextinguished exposures shadowing current eligibility and investment decisions. What is required is a more progressive scheme that accepts a realistic statute of limitations for claims and works cooperatively with industry to ensure funding for R&D projects can be more readily obtained.

While the scheme has delivered benefits to GM Holden, the industry and the Australian economy, from GM Holden’s experience the impact of the benefit is insufficient to enable decisions to invest in very high risk R&D and thereby to foster the transformation that the motor vehicle industry needs to make in the next decade.

In addition, GM Holden believes that the current $1 million threshold for the R&D tax offset for small companies is insufficient to encourage them to increase their investment in innovation. GM Holden sees this as critically important to support the automotive industry as significant innovation is often generated by companies outside the core industry. For example, the lithium-ion battery was initially developed within the consumer electronics industry for application in mobile phones. Today, GM is working to

develop manufacturing capability to allow larger batteries to be used in electric vehicles such as the Chevrolet "Volt".

In GM Holden's view, there are some major adjustments required to the current innovation and R&D incentive mechanisms which are available to the automotive industry to encourage further innovation. In particular, the R&D tax concession needs urgent review.

GM Holden's views have been discussed in more detail in our submissions to the Reviews of the National Innovation System and Australian Automotive Industry.

While GM Holden welcomes the proposed changes to the R & D Tax Concession contained in Dr Terry Cutler's report of the Review of the National Innovation System, we note that:

- The Cutler Report recommendation to implement a tax rebate/credit system for the R&D tax concession to provide an effective 10 per cent increase in the benefit is below the level recommended in GM Holden's submission to the Cutler Review. For large businesses, we maintain our recommendation that the benefit of the R&D tax concession/rebate should be at least 15 per cent.
- The Cutler Report recommends modifications to the R&D tax concession criteria so that IP ownership, overseas funding/support and technical assistance are not impediments to eligibility. GM Holden fully supports this concept on the basis that we consider that the value of the knowledge, education and supplier capability enhancement that flows from R & D work is likely to be significantly greater than the incentive provided. However, the Cutler Report does not provide sufficient certainty as to how any changes to the criteria will achieve this aim. We recommend that this Review of Australia's Future Tax System consider the recommendations in Dr Cutler's Report to ensure that modifications are made efficiently.
- The Cutler Report recommendations provide no guidance on the timing of use of the tax rebates or credits. The new rules must be introduced with the intention of providing incentives to manufacturers, and this is paramount in the planning. Companies will not be encouraged to conduct R & D activities if rules governing payment of tax rebates or credits are too restrictive.
- An alternative to assist the immediate benefit of a tax concession/rebate flowing through to maintenance of workforce numbers is to consider allowing R&D rebates or credits to be offset against other taxes or duties in any circumstance where an employer is unable to obtain immediate benefit via the income tax system due to accumulated income tax losses. For example, the rebate or credit could be financed via a payroll tax offset.
- We agree that the R&D tax concession should be replaced with an R&D rebate system so that all companies (not just those eligible for the R&D tax off-set) may obtain cash benefit. The competitive and cyclical nature of our industry means that companies that are undertaking R&D activities are not always profitable and so can not utilise the R&D tax concession in tax loss years.