Luxury car tax gap

How we estimate and reduce the luxury car tax (LCT) gap for 2021–22.

Published 31 October 2024

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Overview

What makes up the LCT gap population.

Published 31 October 2024

The **luxury car tax (LCT) gap population** is made up of:

- businesses required to register and lodge returns for LCT and goods and services tax (GST)
- entities that apply for LCT refunds and do not have LCT registration obligations
- private luxury car importers, typically individuals purchasing cars for private usage.

The LCT gap forms a part of our overall tax performance program. For more information, see **tax gaps and the latest gaps available**.

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Latest estimate and trends

Compare the 2021–22 LCT gap to trends from previous years.

Published 31 October 2024

The luxury car tax (LCT) gap is the difference between the luxury car tax the ATO expects to collect and what we would have collected if every taxpayer was fully compliant with tax law, also known as the theoretical tax liability.

For 2021–22, we estimate a LCT net gap of 6.1% or $61 million. This means nearly 94% of the total theoretical tax liability is expected to be collected. Gross performance is at 92.6%, compared to the average of around 88% in the previous 5 years. During each year, amendments due to ATO compliance activity have accounted for around 1 - 2% of the theoretical liability, which is similar to the 5 year average for the period 2016–17 to 2020–21.

Compared to 2020–21, the net gap has declined in 2021–22, as strong demand and price conditions in the luxury car market saw faster growth in the expected tax collections relative to the theoretical liability.

The gap estimates have shown volatility from year to year. Analysis suggests that the size of this gap is sensitive to movements in macroeconomic factors. These include exchange and interest rates, as well as the performance of housing markets. The sensitivity of the LCT gap is further exacerbated by several factors, such as its relatively small tax base and the discretionary nature of luxury car purchases.

The key behaviours contributing to the LCT gap include entities who:

- engage in fraudulent schemes to extract the LCT from the sale of a car via incorrect quoting or claiming LCT refunds
- deliberately operate outside the system and are reckless towards their obligation to register for LCT
- erroneously or incorrectly classify imported vehicles to avoid paying LCT
- fail to understand their record keeping and reporting obligations due to lack of understanding the LCT legislation.

Table 1: Luxury car tax gap, 2016–17 to 2021–22

Element	2016–17	2017–18	2018–19	2019–20	202
Population	2,146	2,141	2,228	2,423	2,8
Gross gap ($m)	43	145	90	115	
Amendments ($m)	8.2	21.0	12.4	6.5	

Net gap ($m)	35	124	78	109	
Expected tax collections ($m)	675	693	668	640	8
Theoretical liability ($m)	710	816	746	748	9
Gross gap (%)	6.1%	17.7%	12.1%	15.4%	7
Net gap (%)	4.9%	15.1%	10.4%	14.6%	6

Figure 1 shows the trend in the gross and net tax gap estimates over the same period.

Figure 1: Gross and net LCT gap (percentage), 2016–17 to 2021–22

Figure 1 is a chart showing the gross and net luxury car tax gap as a percentage from 2016–17 to 2021–22 – as outlined in Table 1.

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ATO action to reduce the gap

How we support our clients to meet their compliance obligations.

Published 31 October 2024

Luxury car tax (LCT) is paid by:

- businesses that sell or import luxury cars
- individuals who directly import luxury cars.

The LCT is imposed only if both the:

- value of the car exceeds the LCT threshold

- sale of the car occurs within 2 years of manufacture or importation.

Our data and experience show most people try to comply with their LCT obligations. We aim to make it as easy as possible to help them meet their obligations by providing:

- up-to-date information on our website
- specific advice where requested or where the law is unclear.

We focus on those who actively try to avoid their LCT obligations. Some of the behaviours we are most concerned about include:

- resellers who undercut legitimate dealers on price by evading LCT and GST on luxury car sales
- entities who attempt to pass off private luxury car purchases, for example, a private car collection as a trading enterprise to fraudulently access LCT and GST benefits
- dealers or resellers falsely asserting that luxury cars are being held solely as trading stock when the cars are being used frequently for 'extended' test drives, personal use or informally leased or sold.

Our compliance work targets these behaviours by:

- reviewing new LCT registrants and educating them when they are ineligible to claim LCT refunds
- letting taxpayers know we are targeting arrangements designed to avoid LCT and highlighting the risks of participating in them
- increasing our review of dealers accepting inappropriate ABN quoting, which facilitates the avoidance of LCT by entities who are ineligible to quote ABN to defer paying LCT
- commenced data-matching of luxury car importation information to review the legitimacy of ABN quoted by entities who are outside the system (unregistered) or registered but are ineligible to use the ABN quoting provision
- stopping and verifying LCT refunds and applying administrative penalties to taxpayers who provide misleading or false information
- applying anti-avoidance provisions to artificial and contrived arrangements to avoid payment of LCT
- prosecuting people who undertake fraudulent or criminal activity.

In 2021–22, the ATO increased its focus on fake claims. This fraudulent activity impacted LCT. The unusual growth in LCT refund claims were made by previously unregistered individual entities through lodgments of activity statements. These activities were detected over 2019–20 to 2021–22 and the largest impact was observed in 2021–22. Where detected, the fraudulent claims have been stopped or remediated, with an intensive focus by the ATO currently to recover refunds paid to fraudsters.

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Methodology

What method we use to estimate the LCT gap.

Published 31 October 2024

6-step top-down method

We use a 6-step top-down approach to estimate the luxury car tax (LCT) gap. To derive the theoretical LCT payable in any year, our estimate draws on:

- motor vehicle registration data
- Vendor Field Analytical and Characterisation Technologies System (VFACTS)
- additional internal ATO data.

Due to the data quality issues in the unit record price information within the registration dataset and new registrations not adequately capturing the total volume of new cars sold which attract LCT, we have applied a clustering approach. Cars are first separated into groups, or 'clusters', based on similar attributes to produce price distributions of those cars within each cluster. We then derive the proportions of the price distributions above the LCT thresholds for all clusters and map them to the number of vehicle transactions from the VFACTS data that fall within those clusters. The prices and volumes are subsequently multiplied together and aggregated to produce an overall estimate of the theoretical tax liability. The more detailed steps are outlined below.

Step 1: Decode and standardise vehicle data

The Vehicle Identification Numbers (VINs) from registration data are decoded to obtain the correct vehicle information, such as:

- make and model configurations
- fuel consumption.

This ensures the naming conventions are consistent across vehicles and allows us to compare elements of the sales data. The formats and information reported in these data sets have different structures, which frequently require manual review to obtain the best match possible.

Step 2: Remove LCT-exempt vehicles and LCT from vehicle prices

We remove registration and transaction data associated with vehicle types not subject to LCT, such as:

- dealer registrations
- emergency and commercial vehicles
- registrations older than 2 years from the time of manufacture or importation.

We then remove the LCT components from the purchase prices to obtain the values of the vehicles (inclusive of GST).

Step 3: Develop vehicle clusters and price intervals

We determine vehicle clusters based on the manufacturer, number of cylinders and body type. Using this set of separating criteria should result in similarly valued cars, for deriving the price distributions of new cars by cluster based on the registration data. Our key assumption is that pricing is typically driven by vehicle performance and features.

Fuel-efficient and non-fuel-efficient cars have different thresholds above which LCT is payable. These can be different by year, so we separate them into clusters by year. This allows us to consistently determine the LCT payable for similar vehicle types.

For each cluster, we derive the representative value of vehicles exceeding the LCT thresholds. To address the issue of the representative value being skewed by high-value cars, the price observations of LCT-applicable cars above the LCT thresholds are split into 20 intervals for each cluster.

The representative value within each interval is constructed from the mid-point between the mean and the maximum of the value spread in each interval. Here we are assuming that the actual mean lies between the reported mean and the maximum of the reported values.

Step 4: Determine LCT payable for each interval

We estimate the LCT payable for each price interval within a cluster.

To obtain the values of vehicles that are subject to LCT for each interval within a cluster we:

1. Obtain the quantity sold in each cluster from VFACTS.
2. Multiply by the proportion of cars in the cluster that meet the relevant LCT threshold (giving the number of LCT-applicable cars in the cluster).
3. Divide by 20 (the number of intervals in the cluster) to give the number of LCT-applicable cars in each interval.
4. Determine the marginal value above the threshold by taking the difference between the representative value in Step 3 and the LCT threshold in each interval.
5. Multiply the number of LCT-applicable cars by the marginal value.
6. Remove the GST component by multiplying by 10/11.
7. Multiply by the LCT rate of 33% to obtain the corresponding LCT payable for all units sold in each price interval.

Step 5: Calculate total theoretical liability

The total theoretical liability is determined by aggregating the LCT payable for all price intervals, in all clusters.

Step 6: Calculate gross gap and net gap

The gross gap is the difference between the theoretical LCT liability and accrued LCT revenue excluding the compliance amounts.

The net gap is the residual gap amount after compliance amounts have been considered in the revenue base. We calculate the unreported amount by subtracting non-pursuable debt from the net gap amount.

Summary of the estimation process

Table 2 shows the:

- summary of each step of the estimation process
- results for each year.

Table 2: Summary of estimation process for the luxury car 2021–22

Step	Description	2016–17	2017–18	2018–19	2019–20
1-5	Theoretical tax liability ($m)	710	816	746	748
6.1	Less final tax reported ($m)	684	707	676	647
6.2	Equals final LCT liability not reported ($m)	26	109	70	101
6.3	Add non-pursuable debt ($m)	8.7	14.6	7.8	7.8
6.4	Equals net gap ($m)	35	124	78	109
6.5	Add compliance	8.2	21.0	12.4	6.5

	outcomes and taxpayer adjustments ($m)				
6.6	Equals gross gap ($m)	43	145	90	115
6.7	Gross gap (%)	6.1%	17.7%	12.1%	15.4%
6.8	Net gap (%)	4.9%	15.1%	10.4%	14.6%

Find out more about our overall research methodology, data sources and analysis for **creating our tax gap estimates**.

Limitations

The following caveats and limitations apply when interpreting the LCT gap estimates:

- All vehicle data is mapped by a unique VIN for each vehicle. We match VINs to the information on the specifications of the vehicles based on the first 8 or 9 digits of the VINs rather than the entire 17 digits.
- Resource-intensive data manipulation is required to:
  - identify the LCT-applicable population by analysing over 1,000 models and makes of cars to determine an estimated purchase price (or range) for each new or imported vehicle
  - determine fuel-efficient LCT vehicles by combining the volume of sales data from VFACTS and registration data
  - map line-by-line registration data to the semi-aggregated VFACTS data — due to inconsistencies in the data formats and information reported, this requires extensive manual reviews to find the best match available.
- Due to some data quality issues, some vehicles may be incorrectly categorised as non-fuel-efficient (or fuel-efficient) or misclassified to a cluster.

- Overall, the estimates can be sensitive to the clustering method applied. There is an element of judgment when grouping the cars based on their likeness.
- At this stage we are uncertain on the shadow economy impacts. More work needs to be done to isolate these amounts.

Updates to previous estimates

Each year we refresh our estimates in line with the annual report. Changes from previously published estimates occur for a variety of reasons, including:

- improvements in methodology
- revisions to data
- additional information becoming available.

Figure 2 displays the net gap from our current model compared to the previous estimates.

Figure 2: Comparison of previously published estimates – LCT gap

Figure 2 is a chart showing the net luxury car tax gap estimates of 2009–10 to 2021–22 years from previously published years – as outlined in Table 3.

This data is presented in Table 3 below.

Table 3: Current and previous luxury car tax net gap estim

Program year	2009–10	2010–11	2011–12	2012–13	2013–14
2024	n/a	n/a	n/a	n/a	n/a
2023	n/a	n/a	n/a	n/a	n/a
2022	n/a	n/a	n/a	n/a	n/a
2021	n/a	n/a	n/a	n/a	8.1

2020	n/a	n/a	n/a	n/a	8.1
2016	3.9	5.8	4.6	5.1	4.7
2015	4.1	4.3	4.1	4.3	3.3
2011	4.9	5.2	n/a	n/a	n/a

Reliability

How we make sure the tax gap estimate is reliable.

Published 31 October 2024

We seek feedback and advice about how we estimate the gap from our external and internal subject matter experts. Based on the advice, the reliability for this estimate is **medium** with a score of 19.

Figure 3: Reliability rating scale from very low to very high – LCT gap

This image is a graph that represents the reliability rating for the current luxury car tax gap estimate. The rating scale includes: - Very low which is a score between 0 and 10 - Low which is a score between 11 and 15 - Medium which is a score between 16 and 20 - High which is a score between 21 and 25 - Very high which is a score between 26 and 30. The graph shows the LCT gap estimate has a rating of 19 which is medium.

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