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Luxury car tax gap

How we estimate and reduce the luxury car tax (LCT) gap for 2020–21.

Last updated 30 October 2022

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Overview

What makes up the LCT gap population.

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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. Find out more about the concept of **tax gaps and the latest gaps available**.

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Latest estimate and trends

Compare the 2020 - 21 LCT gap to trends from previous years.

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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 the 2020–21 financial year, we estimate a net luxury car tax (LCT) gap of 7.7% or $73 million. In other words, more than 92% of the total theoretical tax liability is expected to be collected. Gross performance for 2020–21 is at 91.5%, compared to the average of around 87% in the

previous 5 years. During the year, amendments due to ATO compliance activity have accounted for around 0.8% of theoretical liability, which is below the six-year average of 1.3% for the period of 2015–16 to 2020–21, consistent with the impact of COVID-19 on the level and type of compliance activities undertaken by the ATO.

Compared to 2019–20, the net gap has fallen significantly in 2020–21, 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.

This year, there had been revisions in our historical gap estimates to reflect more complete motor vehicle sales data being used in the estimation process. This new data provides more accurate price distributions of new cars sold for estimate years of 2017–18 to 2019–20, which has lead to an increase in the gap estimates for those years. Including new data has also contributed to the increase in the reliability rating for this tax gap estimate.

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, 2015–16 to 2020–21

Element	2015–16	2016–17	2017–18	2018–19	201 20

Population	2,132	2,139	2,129	2,210	2,4
Gross gap ($m)	90	44	150	92	
Amendments ($m)	5.4	8.2	21.0	12.4	
Net gap ($m)	84	36	129	79	
Expected tax collections ($m)	610	676	691	667	6
Theoretical liability ($m)	694	712	820	747	
Gross gap (%)	12.9	6.2	18.3	12.3	1
Net gap (%)	12.2	5.1	15.8	10.6	1

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), 2015–16 to 2020–21

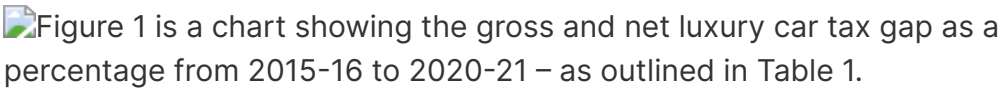
Figure 1 is a chart showing the gross and net luxury car tax gap as a percentage from 2015-16 to 2020-21 – as outlined in Table 1.

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ATO action to reduce the gap

How we support our clients to meet their compliance obligations.

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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
- 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 established a task force, **Operation Protego**, to tackle increased fraudulent GST refund claims. The impacts of the fraudulent activities were also seen in other indirect taxes including 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, for which tax gap estimates will not be published until late in 2024. 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.

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On this page

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

- 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 the fact that new registrations are not adequately capturing the total volume of new cars sold which attract LCT, we have applied a clustering approach by first grouping cars into groups, or 'clusters', based on the similarities of their attributes to produce price distributions of those cars within the clusters. We then derive the probabilities of the price distributions above the LCT thresholds for all clusters, respectively, 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 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 compare the best match possible.

Step 2: Remove LCT-exempt vehicles and LCT from registered vehicle price

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 manufacturer, number of cylinders and body type which should result in similarly valued cars, for the purpose of deriving 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 beyond 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 probability and 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 probability for each price interval as a share of the total price distribution for each cluster is the same.

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 obtain 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. Determine the marginal value above the threshold by taking the difference between the representative value in Step 3 and the LCT threshold.
2. Remove the GST component by multiplying the marginal value by 10/11.
3. Multiply this by its associated probability in the cluster price distribution.
4. Multiply by the quantity sold to obtain total marginal value (exclusive of GST) that is subject to LCT.
5. 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 excluding 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 2020–21

Step	Description	2015–16	2016–17	2017–18	2018–19
1-5	**Theoretical tax liability ($m)**	694	712	820	747
6.1	**Less final tax reported ($m)**	617	684	705	675
6.2	**Equals final LCT liability not reported ($m)**	78	28	115	72
6.3	**Add non-pursuable debt ($m)**	6.6	8.3	14.0	7.5
6.4	**Equals net gap ($m)**	84	36	129	79
6.5	**Add compliance outcomes and taxpayer adjustments ($m)**	5.4	8.2	21.0	12.4
6.6	**Equals gross gap ($m)**	90	44	150	92

6.7	**Gross gap (%)**	**12.9**	**6.2**	**18.3**	**12.3**
6.8	**Net gap (%)**	**12.2**	**5.1**	**15.8**	**10.6**

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 on 8 or 9 digits of the VINs rather than the entire 11 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 link the best match available.
- Due to some data quality issues, some vehicles are categorised as fuel-efficient when they are not. This reduces the potential amount of LCT because fuel-efficient vehicles are subject to a higher threshold.
- Overall, the estimates can be sensitive to the clustering method applied. It contains an element of judgment by the analysts while 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 and revisions 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 gross gap and net gap from our current model compared to the previous estimates.

Figure 2: Comparison of previously reported estimates – LCT gap

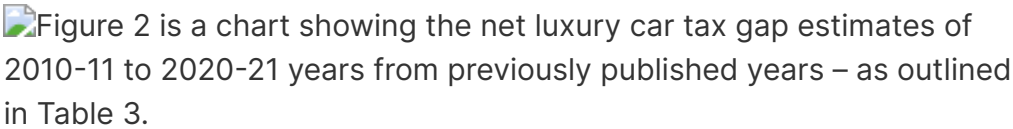
Figure 2 is a chart showing the net luxury car tax gap estimates of 2010-11 to 2020-21 years from previously published years – as outlined in Table 3.

This data is presented in Table 3 below.

Table 3: Current and previous luxury car tax gap estimate

	2009–10	2010–11	2011–12	2012–13	2013–14
2023 program	n/a	n/a	n/a	n/a	n/a
2022 program	n/a	n/a	n/a	n/a	n/a
2021 program	n/a	n/a	n/a	n/a	8.1
2020 program	n/a	n/a	n/a	n/a	8.1

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

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Reliability

How we make sure the tax gap estimate is reliable.

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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

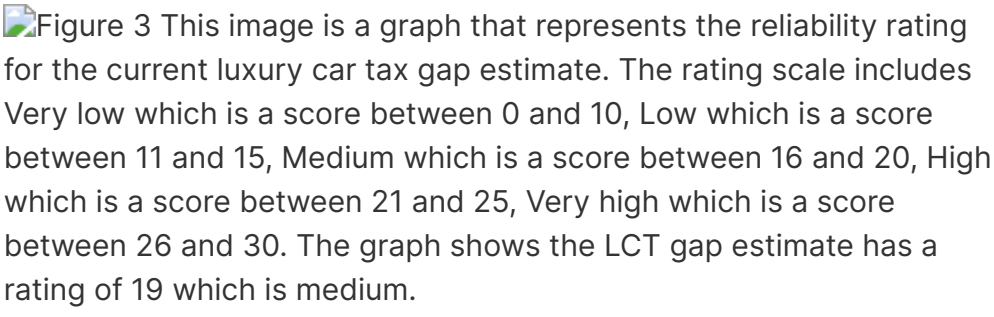
Figure 3 This image is a graph that represents the reliability rating for the current luxury car tax gap estimate. The rating scale includes Very low which is a score between 0 and 10, Low which is a score between 11 and 15, Medium which is a score between 16 and 20, High which is a score between 21 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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